Executive Compensation Practices
Regional Transportation District

Performance Audit
March 2010

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Members of the Legislative Audit Committee:

This report contains the results of a performance audit of executive compensation practices at the Regional Transportation District. We performed this audit in response to a legislative request. The audit was conducted pursuant to Section 32-9-115(3), C.R.S., which requires the State Auditor to conduct a performance audit of the Regional Transportation District at least once every five years. The report presents our findings, conclusions, and recommendations, and the responses of the Regional Transportation District Board of Directors, the Regional Transportation District, and the Regional Transportation District Salaried Employees' Pension Trust.

Sally Symanski

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Glossary of Terms and Abbreviations

457 Plan – A deferred compensation retirement plan created in accordance with Section 457 of the Internal Revenue Code that allows employees to defer a portion of their compensation on a pre-tax basis for use in future years.

Board – Regional Transportation District Board of Directors. A 15-member publicly elected board of directors responsible for governing and overseeing the Regional Transportation District.

District – Regional Transportation District. A special district and political subdivision of the State of Colorado statutorily charged with developing, maintaining, and operating a mass transportation system whose service area includes all of Denver, Boulder, Broomfield, and Jefferson counties, and portions of Adams, Arapahoe, Douglas, and Weld counties.

Excess Benefit Plan – A qualified retirement plan established under Section 415(m) of the Internal Revenue Code to provide retirement benefits that would not otherwise be payable due to federal limits on the annual amount that can be paid to a plan beneficiary under a governmental defined benefit retirement plan.

FasTracks – The Regional Transportation District's comprehensive transit expansion plan to provide additional commuter rail, light rail, bus, and parking services.

Pension Plan – Regional Transportation District Salaried Employees' Pension Trust. A single-employer qualified defined benefit pension plan under Section 401(a) of the Internal Revenue Code maintained by the Regional Transportation District and covering all non-union, full-time salaried employees age 21 and over. The Pension Plan is overseen by a seven-member Board of Trustees, which is appointed by the District's Board of Directors and includes both Board members and District staff.

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Authority, Purpose, and Scope

This performance audit was conducted pursuant to Section 32-9-115(3), C.R.S., which requires the State Auditor to conduct a performance audit of the Regional Transportation District (District) at least once every five years. We performed this audit in response to a May 2009 legislative request asking for a review of executive compensation practices at the District. Accordingly, we reviewed the processes and practices used by the District's Board of Directors (Board) to establish and oversee the compensation package and employment agreements for the District's former general manager, who resigned effective July 31, 2009. We performed audit work from August 2009 through March 2010. We acknowledge the cooperation and assistance provided by the District's management, staff, and Board.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Overview

The Regional Transportation District is a political subdivision of the State and is statutorily charged with developing, maintaining, and operating a mass transportation system for the benefit of the District's inhabitants. The District's service area includes all of Denver, Boulder, Broomfield, and Jefferson counties, and portions of Adams, Arapahoe, Douglas, and Weld counties. The District is governed and overseen by a 15-member publicly elected board of directors. The Board hires a general manager who serves as the District's chief executive officer and reports directly to the Board. The District's former general manager served a total of 14 years from August 1995 through July 2009.

Key Findings

Executive Compensation

Overall, we found that the Board did not provide due consideration and scrutiny or adhere to established best practices in executive compensation when developing the former general manager's employment agreement and total compensation package. Further, the Board lacked a compensation philosophy, or framework, for guiding decisions about the former general manager's employment agreement. Consequently, the Board cannot demonstrate to taxpayers that the terms of the employment agreement or the sums paid to the former general manager were reasonable and appropriate and had a valid basis.

Benchmarking. The Board did not conduct sufficient benchmarking analyses against external market data or internal compensation practices to ensure the compensation paid to the former general manager was reasonable. First, although the Board collected compensation data from five other transit agencies named in the former general manager's employment agreement, the Board did not compare similar compensation elements (e.g., base salary to base salary). Second, the Board could not demonstrate the basis for selecting the five peer transit agencies it used for this compensation comparison. Third, the Board only assessed movement in salaries at these other transit agencies; it did not compare actual salary data to establish a salary range and market midpoint for the general manager position. According to data gathered by the Board as part of its search for a new general manager, the 2009 base salary paid to general managers at 18 other public transit agencies ranged from \$135,000 to \$310,000, with a median base salary of about \$245,500 per year. By comparison, the former general manager's 2009 base salary was about \$295,300, which placed him above the median and at the high end of the salary range. Finally, the compensation and benefits that the former general manager received were significantly more generous than those available to the District's other salaried employees. For example, the former general manager earned 2½ years of service credit in the Salaried Employees' Pension Plan (Pension Plan) for each year worked, whereas all other salaried employees earn only one year of service credit for each year worked. This higher service credit accrual rate increased the former general manager's annual retirement benefit by about \$174,700 per year.

Compensation Package Costs. In February 2001 the Board approved an employment agreement granting the former general manager an accelerated service credit accrual rate in the Pension Plan. However, the Board did not receive an actuarial estimate of the cost of this additional retirement benefit until May 2001, more than two months later. Moreover, we found this actuarial estimate was based on outdated and incomplete salary information provided to the Pension Plan's contract actuary. As a result, the cost estimate provided to the Board in May 2001 significantly understated the cost of the additional retirement benefit. As of February 2010, the estimated total value of the former general manager's accelerated service credit benefit was about \$1.7 million—an amount the Board was not fully aware of before approving the former general manager's employment agreement.

Pay and Performance. The Board had not conducted a comprehensive performance evaluation of the former general manager since February 2000. Consequently, the Board did not evaluate many of the core competencies that could be considered important to the general manager's overall performance. Additionally, the monetary incentive program, which awarded the former general manager a payment equal to 2.5 percent of his base salary for achieving each of five different performance goals, was poorly implemented. First, a number of performance goals established for the former general manager between 2001 and 2009 were not appropriate for incentive payments, since they could reasonably be considered part of the position's basic job requirements. Second, the Board failed to establish performance goals and evaluate their achievement within established contractual time frames. Finally, the Board was not consistent or thorough in its documentation and tracking of the performance goals tied to the monetary incentive program. As a result, we found two instances in which the Board inadvertently paid the former general manager twice for achieving performance goals that were only achieved in one year.

Board Oversight and Governance

Overall, we found the Board largely neglected its oversight and governance responsibilities in several key areas once the former general manager was hired in 1995.

Public Transparency. The Board did not use existing mechanisms effectively to ensure transparency and provide complete information about the former general manager's employment agreement and compensation package to the public. First, although the employment agreements set forth the contractual compensation and benefit requirements, the agreements did not adequately communicate the full cost of the compensation package. Second, the financial statements for both the District and the Pension Plan lacked disclosure regarding the former general manager's unique retirement and deferred compensation benefits. Third, we found no evidence that the Board discussed in an open meeting the dollar value of the total compensation package or the rationale for the pay elements it approved as part of the former general manager's 2007 employment agreement.

Contract Management. We identified several instances in which the Board over- or underpaid the former general manager due to incorrect applications of provisions outlined in the employment agreement. For example, the Board calculated monetary incentive payments for achievement of goals in 2002 and 2003 on the basis of salaries effective in the subsequent years, rather than salaries effective during the performance years. This error resulted in a total overpayment of about $2,100. Also, in 2005 the Board awarded the former general manager a monetary incentive payment of 10 percent of his base salary. However, since he had met all five of his 2004 performance goals, he was eligible for a payment equal to 12.5 percent of his base salary. This error resulted in a total underpayment of about $5,600.

Business Expenses. We identified unallowable expenses and/or insufficient supporting documentation for 31 of 114 (27 percent error rate) sampled expense reimbursements and purchasing card transactions made by the former general manager and 13 other senior managers during Calendar Year 2008. For example, eight transactions totaling about $400 were for travel to and from Denver International Airport. District policy does not allow these expenses to be claimed for reimbursement. Ten transactions totaling about $1,225 were for business meetings that lacked sufficient documentation of the meeting's purpose or attendees as required by District policy.

Board Governance. We identified several ways in which the Board's practices may impede its ability to ensure efficient and effective governance. First, the District's internal audit unit does not report functionally to the Board and, therefore, lacks sufficient organizational independence from District management. Second, the Board lacks charters for its standing committees and has not established standing compensation or audit committees. Third, the Board lacks a written governance manual to facilitate its operations. Fourth, the Board does not have a succession plan for the general manager position. Finally, the Board does not leverage available resources (e.g., hiring outside consultants) when needed to obtain expertise in specialized areas such as executive compensation.

Our recommendations and the responses from the Board, the District, and the Pension Plan can be found in the Recommendation Locator and in the body of this report.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	24	Ensure that the general manager's employment agreement and total compensation package are reasonable and appropriate and have a valid basis by (a) benchmarking all key elements of the general manager's total compensation package and develop a salary range and market midpoint for the general manager position, (b) ensuring that benchmarking analyses are based on a comparison of compensation elements that are equivalent or similar in function and scope, (c) conducting benchmarking analyses each time the general manager's employment agreement is renegotiated, (d) defining clear criteria to use in selecting an appropriate peer group and document reasons that certain organizations are included in the peer group and others are excluded, (e) reviewing the peer group and the selection criteria on an annual basis and making necessary changes, (f) seeking specialized expertise from outside consultants when necessary, and (g) documenting any departures from the results of the benchmarking analyses.	Regional Transportation District Board of Directors	Agree	October 2010
2	29	Obtain complete cost data on the terms of the general manager's employment agreement and total compensation package prior to approving the agreement. Use a tally sheet or similar mechanism to compile and review annually all major components of the general manager's employment agreement and their related costs.	Regional Transportation District Board of Directors	Agree	Implemented and Ongoing

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
3	31	Develop and implement a formal process for annually evaluating the general manager's performance by (a) establishing performance standards and accompanying evaluation factors that are comprehensive and highlight the core competencies and skill sets required to perform the job, (b) defining a metric for each performance standard and evaluation factor, (c) providing a written performance evaluation to the general manager annually and maintaining a copy in the general manager's personnel file, and (d) using the annual performance evaluation as the basis for determining increases in the general manager's base salary.	Regional Transportation District Board of Directors	Agree	December 2010
4	37	Reevaluate the monetary incentive program for the general manager by (a) defining the incentive program's purpose, including the specific behaviors and outcomes the Board is attempting to motivate and achieve; (b) defining how performance goals tied to incentive payments are different and distinguishable from the general manager's overall performance expectations and job responsibilities; (c) establishing a clear process for developing and vetting performance goals for the general manager; and (d) developing performance goals and reviewing their achievement in a timely manner as prescribed by the employment agreement.	Regional Transportation District Board of Directors	Agree	Implemented

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
5	39	Develop and adopt a formal compensation philosophy to guide the design, implementation, and evaluation of the general manager's employment agreement and compensation package by (a) ensuring that the compensation philosophy outlines general guiding principles on total compensation and value, details the purpose and rationale for specific compensation elements and the relationship between them, and establishes a clear relationship between pay and performance; (b) reviewing the compensation philosophy and making appropriate revisions on an annual basis; and (c) considering developing and adopting a comprehensive compensation philosophy that extends beyond the general manager to include the District's other senior managers and employees.	Regional Transportation District Board of Directors	Agree	October 2010
6	47	Ensure transparency with respect to the general manager's employment agreement and compensation package by (a) providing the public with comprehensive cost information through tally sheets or another cost summary statement; (b) obtaining an update at each Board meeting regarding key compensation committee activities; and (c) holding an annual briefing, in an open meeting, that covers in detail the various components and associated costs of the general manager's employment agreement and compensation package.	Regional Transportation District Board of Directors	Agree	October 2010
7	48	Completely and accurately disclose in its financial statements any unique benefits provided to a District employee or group of employees. To the extent that any unique benefits are still being paid or provided to the former general manager, such information should also be disclosed.	Regional Transportation District	Agree	May 2010

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
8	49	Completely and accurately disclose in its financial statements any unique retirement benefits provided to a plan participant or group of plan participants. To the extent that any unique retirement benefits are still being paid or provided to the Regional Transportation District's former general manager, such information should also be disclosed.	Regional Transportation District Salaried Employees' Pension Trust	Agree	May 2010
9	51	Ensure more effective oversight and management of the general manager's employment agreement and compensation package by (a) developing a clear process with assigned accountabilities for reviewing and approving all compensation calculations for the general manager's contract, and (b) working with the Board's general counsel to review the final language of the general manager's employment agreement and ensure that it accurately reflects mutually agreed upon terms.	Regional Transportation District Board of Directors	Agree	Implemented and Ongoing
10	54	Improve internal controls to provide for more thorough review and approval of the general manager's and other senior managers' business expenses and purchasing card statements to ensure compliance with District policies and procedures. Permitted deviations from established policies and procedures, as well as the reasons for such deviations, should be identified and approved separately.	Regional Transportation District Board of Directors and Regional Transportation District	Agree	Implemented
11	61	Improve the organizational independence of the District's internal audit function by redefining the internal audit unit's functional reporting line and associated activities in accordance with established professional standards in internal auditing. The Board should also review the internal audit unit's administrative reporting line and make any necessary changes.	Regional Transportation District Board of Directors	Agree	July 2010

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
12	61	Ensure the Board's committee structure promotes accountability, an adequate division of labor, and subject matter expertise by (a) adopting charters for each standing committee and ad hoc committee, (b) establishing a standing compensation committee and a standing audit committee, and (c) reevaluating use of the committee of the whole as the primary means of organizing the Board's standing committees and committee activities.	Regional Transportation District Board of Directors	a. Agree b. Agree c. Agree	a. November 2010 b. July 2010 c. Implemented
13	63	Improve governance and oversight practices by (a) developing a written governance manual describing the roles, responsibilities, policies, and procedures for key areas of Board activity and function; (b) developing a succession plan for the general manager and other senior management positions; and (c) leveraging available resources within the Board Office and contracting directly with consultants and subject-matter experts when necessary.	Regional Transportation District Board of Directors	Agree	October 2010

Overview of the Regional Transportation District

Chapter 1

Created in 1969, the Regional Transportation District (District) is a political subdivision of the State of Colorado. Originally the District was created as a transportation planning agency. However, in 1974 the District became an operating entity statutorily charged with developing, maintaining, and operating a mass transportation system for the benefit of the District's inhabitants [Section 32-9-107, C.R.S.].

Currently the District operates approximately 150 regular fixed bus routes and five light rail lines in the Denver Metropolitan Area. The District also provides services for the disabled (i.e., access-a-Ride) and areas lacking fixed route service (i.e., call-n-Ride), as well as special bus service for major sporting and other events. In total, the District's service area covers approximately 2,300 square miles, including all of Denver, Boulder, Broomfield, and Jefferson counties, as well as portions of Adams, Arapahoe, Douglas, and Weld counties. About 54 percent of Colorado's population resides within the District. See Appendix A for a map of the District.

Organization

The District is governed and overseen by a 15-member publicly elected board of directors (Board). Each Board member is elected for a four-year term by the constituents of the director district in which the Board member resides. The Board apportions director districts on the basis of population so that, to the extent practicable, each director district has the same number of constituents.

The Board has broad powers and responsibilities with respect to District operations. Specifically, state statute [Sections 32-9-114 and 119, C.R.S.] enumerates a number of powers, including

- establishing, maintaining, and operating a mass transportation system;

- prescribing a system of business administration; creating necessary offices; and establishing the powers, duties, and compensation of all officers, agents, employees, and other persons contracting with the District;

- levying and collecting sales tax and, in certain circumstances, property tax within the District;
- borrowing money and issuing securities;
- purchasing, trading, exchanging, and disposing of real property or real property interests;
- condemning property for public use; and
- entering into contracts and agreements.

State statute further specifies that the Board may employ officers, agents, employees, and other persons necessary to carry out the District's business and may delegate any executive, administrative, or ministerial powers to such officers and employees. Accordingly, the Board hires a general manager who serves as the District's chief executive officer and reports to the Board. Historically, the general manager's contracted responsibilities have included

- managing the District's affairs under the direction of the Board;
- exercising management control over the District's employees, except those employees who are hired by and report directly to the Board;
- proposing and executing the District's annual budget;
- making recommendations to the Board regarding District operations;
- interpreting and implementing adopted District policies; and
- fulfilling other duties as assigned by the Board.

District operations are divided into eight departments: administration; bus operations; customer and contracted services; general counsel; planning and development; public affairs; rail operations; and safety, security, and facilities. Each department is overseen by an assistant general manager who reports to the general manager.

As of February 2010, the District reported a total of about 2,440 employees, of whom about 630 were salaried and 1,810 were hourly. With the exception of staff in the Board's administrative office, the general manager is the only salaried employee who serves under a contract negotiated directly with the Board. All other salaried positions, including assistant general managers, fall within the District's personnel and compensation system and are overseen by the general manager. The District's hourly employees (primarily bus and light rail operators and mechanics) work under a collective bargaining agreement between the District and the Amalgamated Transit Union, Local #1001.

Fiscal Overview

The District operates on a December 31 fiscal year end. Audited financial statements for Fiscal Year 2009 were not yet available as of the end of our audit; however, for general descriptive purposes, the District provided preliminary figures based on unaudited data. According to these preliminary figures, the District had revenues from all sources totaling about $701 million in Fiscal Year 2009. The District's primary revenue source is a 1 percent sales and use tax levied within the District. The District reported Fiscal Year 2009 sales and use tax revenues totaling about $371 million, or 53 percent of total revenues. Passenger fares accounted for an additional $98 million in revenues. The remaining $232 million in revenues came from federal grants, local contributions, interest income, and other miscellaneous sources.

The District reported Fiscal Year 2009 total operating expenses, including depreciation, of approximately $521 million. Salary, wages, and benefits for District employees accounted for $160 million, or about 31 percent of the District's total expenses. Pursuant to state statute [Section 32-9-119.5, C.R.S.], the District contracts some of its bus services to private contractors. The expense for these contracted transportation services accounted for $104 million, or about 20 percent of the District's total expenses in Fiscal Year 2009. The remaining $257 million was for expenses such as materials and supplies, insurance, utilities, leases and rentals, interest, and depreciation of capital assets.

Audit Scope and Methodology

We performed this audit in response to a May 2009 legislative request asking for a review of executive compensation practices at the Regional Transportation District. Accordingly, we reviewed the processes and practices used by the Regional Transportation District's Board of Directors to establish and oversee the compensation package and employment agreement for the District's former general manager, who resigned effective July 31, 2009. Our audit work included analyzing data, reviewing documents, and interviewing District managers and staff and all 15 members of the Board of Directors. We examined the history of employment agreements and compensation data for the former general manager. We reviewed Board meeting materials to understand how employment agreements were developed and negotiated. We assessed the Board's efforts to evaluate the former general manager's performance and to oversee his employment agreements once in place. Finally, we researched available literature and practices employed by other public and private sector entities to identify best practices in executive compensation programs and board governance. We refer to these best practices throughout the audit report. Our audit did not include the Board's efforts to recruit and select a new general manager, nor did the audit include any other aspects of the District's operations. We expect to complete a review of the District's cost allocation model, which was part of the original legislative request for audit, in late 2010.

Executive Compensation

Chapter 2

The fundamental goal of an executive compensation package is to attract, retain, and motivate high-quality executive officers and senior managers who will contribute to achieving an organization's core objectives. Executive compensation is a topic that has garnered a great deal of attention in the wake of the recent economic downturn and the resulting federal government bailouts of several major U.S. corporations. The public has become increasingly outraged at the size of the compensation packages that many troubled firms awarded their top executives and at the lack of accountability for the use of public funds.

The District is not a publicly traded corporation, nor was it involved in the recent corporate scandals or bailouts. However, the compensation for the District's former general manager has captured the public's attention in recent years. As a government entity, the Board must ensure effective stewardship and accountability for its use of public funds. One of the Board's most important functions is to make decisions about the employment agreement and compensation package for the District's general manager. If the general manager's employment agreement and compensation package are to withstand public scrutiny, the Board must ensure that, regardless of the dollar amounts involved, the compensation package has a valid and reasonable basis and that the Board's process for establishing it promotes public transparency and accountability.

We reviewed the Board's processes and practices for establishing the employment agreement and compensation package for the District's former general manager. We also identified best practices used by other public and private sector entities in designing executive compensation packages. Overall, we found that the Board did not provide due consideration and scrutiny or adhere to established best practices in executive compensation when developing the former general manager's employment agreement and compensation package. Consequently, the Board cannot demonstrate to taxpayers that the terms of the employment agreement or the sums paid to the former general manager were reasonable and appropriate and had a valid basis. This chapter focuses on our review of key components in the former general manager's compensation package. Findings related to Board oversight and the need for more transparency related to executive compensation are discussed in Chapter 3.

Total Compensation

Total compensation plays a significant role in attracting, retaining, and motivating an organization's executive and non-executive employees. Total compensation includes all forms of monetary remuneration, such as base salary, bonuses, short- and long-term incentive payments, and employer contributions to retirement and insurance plans. Total compensation also includes non-monetary remuneration, such as leave benefits, options for flexible hours and workplace, and other intangible benefits.

A large portion of our audit work involved reviewing and analyzing the former general manager's employment agreements and total compensation packages. The former general manager was hired in August 1995 and resigned in July 2009. During this 14-year period, the former general manager and the Board entered into five separate employment agreements. (See Appendix B for key elements of each of the five agreements.) The following table summarizes the total monetary compensation for the District's former general manager between 2007 and 2009, which were his final 2½ years of employment.

Total Monetary Compensation Regional Transportation District's Former General Manager 2007 Through 2009[1]			
	2007	**2008**	**2009[1] (Jan.-July)**
Cash Compensation			
Salaried Earnings[2]	$269,657	$284,624	$181,568
Monetary Incentive Award	$31,591	$33,707	$27,577
Unused Vacation and Sick Leave[3]	N/A	N/A	$268,839
Additional Payments[4]	$1,020	$1,020	$595
Total Cash Compensation	$302,268	$319,351	$478,579
Retirement (Employer Contributions)			
Salaried Employees' Pension Plan	$28,989	$30,529	$44,999
Governmental Excess Benefit Plan[5]	--	$199,530	$154,790
457 Deferred Compensation Plan[6]	$20,500	$20,500	$22,000
Social Security and Medicare	$10,673	$11,214	$13,758
Total Retirement Contributions	$60,162	$261,773	$235,547
Insurance (Employer Contributions)			
Health and Dental	$15,752	$15,990	$10,677
Life, Accident, and Disability	$2,606	$2,606	$809
Total Insurance Contributions	$18,358	$18,596	$11,486
Total Monetary Compensation	**$380,788**	**$599,720**	**$725,612**

Source: Office of the State Auditor's analysis of data provided by the Regional Transportation District.
[1]Amounts are through July 31, 2009, the former general manager's effective resignation date.
[2]Actual wages paid in the calendar year, inclusive of sick leave, vacation, bereavement, and holiday pay.
[3]One-time cash payment for unused vacation and sick leave balances at the time of separation.
[4]The District rewards employees whose good health allows them to use a minimum amount of sick leave.
[5]Employer contributions to a trust fund established by the District to cover the portion of the former general manager's retirement benefit that could not be legally paid by the District's Salaried Employees' Pension Plan.
[6]Employer-paid deferred compensation contributions for the former general manager were made in January of each year. The 2009 contribution was made in full in January 2009.

Our review identified significant concerns with the Board's executive compensation practices, calling into question the basis for and reasonableness of the former general manager's various employment agreements and total compensation packages. Specifically, we found that the Board did not: (1) evaluate the total compensation package against appropriate external and internal benchmarks, (2) obtain and review complete cost data on the total compensation package prior to approving the employment agreements, (3) ensure a strong relationship between pay and performance, or (4) develop an overall compensation philosophy, or framework, to guide all aspects of developing, managing, and evaluating the former general manager's employment agreement and compensation package. We discuss these issues in the remainder of this chapter.

Benchmarking

Benchmarking is a best practice that involves the routine and systematic comparison of an organization's executive compensation program against various external and internal factors. This comparative analysis allows an organization to evaluate its executive compensation program in relation to the market, industry standards, and best practices, as well as to compensation practices within the organization. As described in the following sections, we found that the Board did not conduct sufficient benchmarking analyses against external or internal factors when developing the former general manager's employment agreement and compensation package.

External Market Comparisons

To attract and retain highly talented executives, boards of directors need to offer compensation packages that are competitive in the external labor market. To evaluate competitiveness, organizations typically collect salary survey and other total compensation data from comparable employers. For example, salary survey data can help establish a salary range and midpoint based on actual salaries paid in the market for similar positions. Other elements of the total compensation package, such as performance and incentive pay, health and retirement benefits, and vacation and sick leave, can also be compared with what is offered by similar employers in the market. The Board has historically gathered basic compensation data for general manager positions at other transit agencies. However, we found that the Board's efforts were not sufficient or consistent with established best practices in three key areas and, as a result, did not provide a valid market basis for the former general manager's employment agreement and compensation package.

First, the Board did not compare similar compensation elements when determining increases in the former general manager's base salary, nor did the Board compare the actual base salary paid to the former general manager with actual base salaries paid by other transit agencies. Instead, under the terms of the former general manager's employment agreement, the Board calculated the annual percentage increase in the average *total compensation* paid to general managers at five other transit agencies and applied that percentage increase to the former general manager's *base salary*. It is not valid to compare the general manager's base salary against total compensation paid by other transit agencies. Moreover, this comparison only assesses movement in salaries at other agencies; there is no comparison of actual base salary amounts. In fact, we found that only once during the former general manager's 14-year tenure, in 1998, did the Board use salary survey data to set the actual amount of the former general manager's base salary.

Best practices dictate that each compensation component should be compared with the same compensation component paid by comparable employers. That is to say, base salary should be compared with base salary, incentive plans should be compared with incentive plans, and so forth. Had the Board compared similar compensation elements (i.e., base salary to base salary), it would have found the former general manager ineligible for a base salary increase in 2006 under the terms of the employment agreement because his base salary was already above the average base salary paid by the other five comparison transit agencies. Best practices also dictate that the Board should compare the actual amount of the general manager's base salary with the actual amount of the base salary paid by comparable employers. By only assessing the percentage change in salaries at other transit agencies instead of actual pay, the Board is unable to determine how the general manager's salary compares with the market. We compared the former general manager's 2009 base salary against salary data reported by 18 other public transit agencies. These data were gathered by a consultant the Board hired in July 2009 as part of its search for a new general manager. It is important to note that these data provide only a basic comparison to the market. The Board did not retain its consultant to perform a full salary survey or external benchmarking analysis. According to data provided to the Board by its consultant, the 2009 base salary paid to general managers at the 18 transit agencies ranged from $135,000 to $310,000, with a median base salary of about $245,500 per year. By comparison, the base salary for the District's former general manager was about $295,300 in 2009, which placed him above the median and at the high end of the salary range.

Second, the Board did not design or use its salary survey of other transit agencies to benchmark the former general manager's total compensation package. As discussed previously, best practices dictate that key components of the total compensation package should be compared with the same key components paid by other comparable employers, so that the total compensation package has a valid market basis. However, during our audit District human resources staff expressed concern that the comparability of the data obtained from other transit agencies was limited because not every transit agency reported information for all of the same total compensation elements. By redesigning its salary survey to focus on the general manager's total compensation, the Board could obtain valuable information about other non-base-salary pay elements, benefits, and performance factors from its external market comparisons. For example, the former general manager earned service credit in the District's defined benefit pension plan at a rate that was 2½ times that of other pension plan participants. However, according to recent data gathered by the Board's consultant, only one transit agency reported offering its general manager a higher service credit accrual rate in its defined benefit pension plan. Also, whereas the Board set no limits on vacation and sick leave accruals for the former general manager, 13 other transit agencies reported setting such limits for their general managers. We discuss our concerns with the former general manager's pension benefit and leave accruals in the following section.

Finally, the Board could not demonstrate the basis for the peer group it used for acquiring compensation data from other organizations when establishing the former general manager's employment agreement and compensation package. Best practices in executive compensation establish the use of a peer group as an important part of providing a foundation for executive pay decisions. In 2001 the Board established a peer group of transit agencies in five cities—Atlanta, Cleveland, Dallas, Houston, and Washington, D.C.—in the former general manager's employment agreement for calculating increases in base salary. However, the Board lacked documentation outlining its selection criteria. Accordingly, the Board could not demonstrate why it selected transit agencies in these five cities or, conversely, why it excluded others. For example, the Washington Metropolitan Area Transit Authority in Washington, D.C. and the Metropolitan Transit Authority in Houston, Texas, were included in the peer group. However, according to 2001 data from the National Transportation Database maintained by the Federal Transit Administration, both of these transit agencies were larger than the District in several ways (e.g., service area population, number of employees, annual passenger miles, and operating budget). Other cities in the West with bus and light rail service (e.g., Salt Lake City) were excluded from the peer group. Additionally, although the District is a political subdivision of the State, other political subdivisions, such as large cities or counties, were excluded from the peer group. We further noted that the peer group did not change over time. The Board specified these same five transit agencies in the former general manager's 2001, 2005, and 2007 employment agreements, yet there was no analysis to demonstrate that the five agencies remained an appropriate peer group.

During our audit the District provided a summary of salaries compiled by the American Public Transportation Association for a group of 24 different transit agencies, including the District, with 2,500 or more employees. The five transit agencies named in the former general manager's employment agreement are included in this group, as well as 18 other transit agencies. Under the terms of the former general manager's employment agreement, none of these other 18 transit agencies was used to calculate annual increases in his base salary. Moreover, this list only groups agencies by the number of employees. There could be other relevant criteria for determining a peer group, such as service area size, passenger miles, operating budget, and geographic location. Fundamentally, the Board lacked documentation explaining why the five transit agencies specifically named in the former general manager's 2001, 2005, and 2007 employment agreements constituted an appropriate peer group for market comparison purposes.

Internal Equity Considerations

Best practices in executive compensation suggest that boards of directors should consider internal equity when developing and evaluating executive compensation packages. That is to say, boards of directors should consider executive compensation packages in relation to the benefits and pay relationships for the rest of the organization. However, we found no evidence that the Board considered internal equity when developing the former general manager's employment agreement and compensation package. As we describe below, key elements in the former general manager's employment agreement and compensation package differed significantly from compensation practices for the District's other salaried employees, raising questions about the reasonableness and appropriateness of the compensation package relative to the rest of the organization.

- **Base salary.** The former general manager's base salary significantly exceeded salaries paid to assistant general managers and other salaried employees. For example, in 2009 the former general manager's base salary was about $295,300—nearly twice the average annual salary of the District's assistant general managers ($150,180) and more than quadruple the average annual salary of the District's other salaried employees ($64,290). Additionally, between 2007 and 2009, the former general manager received market-based salary increases that were, on average, about 4 percent higher than the average market-based salary increases received by the District's other salaried staff over the same period. Further, in 2009 the former general manager received a base salary increase of 1.73 percent in accordance with the contractual terms of his employment agreement. Salaries for all other District staff were frozen in 2009.

- **Defined retirement benefits.** The pension benefits negotiated as part of the former general manager's employment agreement were substantially more generous than pension benefits paid to the District's other salaried employees. The former general manager, along with all non-union, full-time salaried employees age 21 and over who were employed by the District prior to January 1, 2008, was covered by the District's Salaried Employees' Pension Plan (Pension Plan). This is a single-employer qualified defined benefit pension plan under the Internal Revenue Code. Employees hired after January 1, 2008, are only eligible to participate in the District's Salaried Employees' Defined Contribution Plan. Employer contributions to the Pension Plan are based on a percentage of the District's total salaried payroll as determined by the Board after receiving a recommended contribution percentage from the Pension Plan's contract actuary. As of January 1, 2009, actuarial analysis showed that the Pension Plan was about 95 percent funded and recommended that the District's contributions be increased to 13.5 percent of total salaried payroll. However, similar to its action from prior years, the Board decided to make contributions of about 9 percent of total salaried payroll instead of adopting the actuarial recommendation. Salaried employees are not required to contribute to the Pension Plan. The District and employees also make contributions to Social Security.

Under the former general manager's employment agreement, he was entitled to additional pension benefits. Salaried employees participating in the Pension Plan earn one year of service credit for each calendar year in which the employee works more than 1,000 hours for the District. Thus, generally speaking, the District's salaried employees accrue service credit in the Pension Plan at a rate of one year for each year worked. However, the 2001 and subsequent employment agreements allowed the former general manager to accrue service credit in the Pension Plan at a rate of 2½ years for each year worked. Further, this provision was applied retroactively to the former general manager's date of hire in 1995. The Pension Plan's rules and regulations were also amended to allow for this increased accrual rate for the general manager position when authorized by the employment agreement. Accordingly, at the time of his resignation in July 2009 after a 14-year tenure with the District, the former general manager had earned 35 years of service credit in the Pension Plan. Thirty-five years of service credit entitled the former general manager to receive an annual defined pension benefit of about 85 percent of his highest average salary after adjusting for early retirement. In contrast, an employee of the same age retiring with 14 years of service credit would receive an annual defined pension benefit of about 34 percent of his or her highest average salary. We determined that the higher service credit accrual rate increased the former general manager's annual retirement benefit from about $116,400 to $291,100 (a 150 percent increase), or by about $174,700 per year.

- **Deferred compensation**. The District contributed to a deferred compensation plan for the former general manager, but the District did not contribute for other employees. Specifically, the 2001 and subsequent employment agreements required the District to contribute the maximum amount allowable by law into the District's 457 Deferred Compensation Plan (457 Plan) on behalf of the former general manager. Accordingly, between 2001 and 2009, the District contributed about $150,500 to the 457 Plan. In contrast, other District employees who choose to participate in the 457 Plan must make their own contributions; the District makes no contributions on their behalf.

- **Vacation and sick leave.** The former general manager's leave benefits were a vehicle for receiving significant additional monetary compensation upon separation. However, according to the District's employee handbook, the intended purpose of vacation and sick leave benefits is to provide employees with time away from work to help ensure a healthy workforce and maintain work-life balance. Under the former general manager's 2001 and subsequent employment agreements, he was allowed to accrue unlimited vacation and sick leave balances. In contrast, the District places maximum limits on accrued vacation and sick leave for all other salaried employees. The former general manager's employment agreement entitled him to cash payment upon separation for 100 percent of his unused vacation and sick leave. Other salaried employees are paid for 100 percent of their unused vacation leave upon separation; however, a salaried employee with 14 years of service would only be paid at a rate of 58 percent for any unused sick leave. When the former general manager resigned in July 2009 after 14 years, he had accumulated about 237 days of unused vacation and sick leave, entitling him to a total cash payment of about $268,800—about $156,600 more than he would have been entitled to under the rules applicable to the District's other salaried employees.

- **Monetary incentive payments.** The former general manager had the unique opportunity to earn additional compensation beyond his base salary through a monetary incentive program. Under the 1995 and 2000 employment agreements, the former general manager was eligible for annual monetary incentive payments of up to 5 percent and 10 percent of base salary, respectively. The 2001 and subsequent employment agreements made the former general manager eligible for an annual monetary incentive payment of up to 12.5 percent of base salary. Between 2001 and 2009, the former general manager received a total of about $215,000 in monetary incentive payments. No other District employee is eligible for monetary incentive payments.

Benchmarking analyses provide a routine and systematic evaluation of key compensation components against various external and internal factors. The Board obtained some compensation data for general managers of transit agencies in other cities. However, as discussed previously, these data-gathering efforts were insufficient for assessing the former general manager's compensation package against the external market. Additionally, the Board did not consider compensation practices applicable to the rest of the organization. Without conducting sufficient benchmarking analyses, the Board cannot demonstrate to taxpayers that the terms of the former general manager's employment agreement and total compensation package were reasonable and appropriate and had a valid basis.

It is critical that the Board exercise due care and consideration when negotiating the general manager's employment agreement and total compensation package. The Board should conduct benchmarking analyses that are comprehensive, systematic, and inclusive of both external market-based factors and internal equity considerations. Benchmarking should take place each time the Board renegotiates the general manager's employment agreement. Even if a contract is not being negotiated, the Board should annually gather and update the relevant external market and internal data. Close attention should be paid to benchmarking base salary since it is often the foundation for other pay components (e.g., the value of incentives and benefits are often calculated as a percentage of base salary). To properly evaluate whether the general manager's base salary is consistent with prevailing salaries at other transit agencies, the Board cannot just look at how market pay rates have increased or decreased. The Board must also look at what the market actually pays and develop an appropriate salary range and market midpoint for the general manager position. The Board should benchmark the total compensation package, not just certain pay elements, and compare compensation elements that are equivalent or similar in function and scope.

Additionally, the Board should select an appropriate peer group on the basis of clearly defined criteria and a well-documented selection process. The Board should review the peer group and the selection criteria on an annual basis and make any necessary changes, since what could be considered an appropriate peer organization in one year may not be in subsequent years. To promote maximum flexibility, the Board should not list the actual peer group in the general manager's employment agreement. Finally, benchmarking and peer group selection are complex endeavors; thus, the Board may need to contract with an outside consultant to provide additional expertise.

The Board may have legitimate reasons for negotiating a compensation package with the general manager that differs from compensation practices at other transit agencies or those applicable to other District employees. Nonetheless, the Board should conduct sufficient benchmarking analyses as a starting point for determining the general manager's total compensation package. Any departures from the benchmarking analyses should be documented to ensure transparency in the Board's decisionmaking process.

Recommendation No. 1:

The Regional Transportation District Board of Directors should ensure that the general manager's total compensation package and employment agreement are reasonable and appropriate and have a valid basis by conducting benchmarking analyses that are comprehensive, systematic, and inclusive of both external market-based factors and internal equity considerations. At a minimum, the Board should:

a. Benchmark all key elements of the general manager's total compensation package, including actual base salary, incentive pay, retirement benefits, vacation and sick leave, and other compensation elements as appropriate. The Board should develop a salary range and market midpoint for the general manager position.

b. Ensure that benchmarking analyses are based on a comparison of compensation elements that are equivalent or similar in function and scope.

c. Conduct benchmarking analyses each time the general manager's employment agreement is renegotiated. In years when the employment agreement is not being renegotiated, the Board should gather and update relevant external market and internal data.

d. Define clear criteria to use in selecting an appropriate peer group and to demonstrate the peer group's appropriateness for assessing the general manager's compensation package and employment agreement against the market. The selection process should be well documented and list the reasons that certain organizations are included in the peer group and others are excluded.

e. Review the peer group and the selection criteria on an annual basis and make necessary changes. The Board should refrain from listing the actual peer group in the general manager's employment agreement.

f. Seek specialized expertise from outside consultants when necessary.

g. Document any departures from the results of the benchmarking analyses when determining the general manager's employment agreement and compensation package to ensure transparency in the decisionmaking process.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: October 2010.

We fully agree that the methodologies previously used to calculate, evaluate, and administer the former general manager's employment agreement and compensation package could have been improved, and those improvements are reflected in the new general manager's contract. The total annual compensation for the new general manager is approximately 57 percent of the total annual compensation for the former general manager in the last year of his contract on an annualized basis. The benefits included in the new general manager's base compensation—including insurance coverage, vacation and sick leave accruals, and retirement benefits—are in accordance with the District's standard payroll practices. That is, the new general manager's compensation follows the same basic compensation process applicable to all of the District's salaried employees. The contract for the new general manager does not include criteria or a request for automatic increases based on a select peer group analysis. None of the extra compensation measures identified by the State Auditor in the former general manager's contract, including accelerated pension service credit accrual, performance incentive pay, paid deferred compensation, or increased sick and vacation accruals, are included in the employment agreement for the new general manager. As another illustration of cost savings, in this case beyond the scope of the contract, the new general manager opted out of the District's medical insurance plan, potentially saving the District thousands of dollars during his employment with the District.

The RTD Board of Directors is committed to continuous improvement in our processes and has initiated several steps to address the concerns expressed by the State Auditor on our benchmarking practice.

a. – e. The Board has created a standing committee named the General Manager Oversight and Performance Management Committee that is responsible for making recommendations to the full Board on incorporating the audit's recommendations for expanded benchmarking into the comprehensive compensation and evaluation process. While the Board did previously gather and review salary information of general managers at comparable transit agencies, as designated by the American Public Transportation Association, this Committee will review the recommendations on benchmarking provided by the State Auditor and will address them as appropriate. This Committee will provide recommendations for implementation to the full Board by October 2010.

f. The Board has hired an outside employment agreement attorney to create an industry-accepted contract based on standard terms and conditions. Under this contract, the compensation for the new general manager follows the same basic compensation procedure as for all RTD salaried staff. The compensation package negotiated for the new general manager is based on a set of guidelines recommended by the Executive Search Committee and agreed to by the full Board. The RTD Board hired an external executive search firm and a liaison firm to provide expertise and assistance during international search for the new general manager.

g. The Board will develop and implement a procedure to document all benchmarking activities to identify any potential departures from the analyses which might occur as part of the general manager's employment or compensation.

Compensation Package Costs

Senior executives are, relative to most employees, typically highly paid individuals. As decisionmakers responsible for overseeing executive compensation programs, boards of directors need to know more than just the type of benefits provided to senior executives. Boards of directors also must know the cost of the benefits being provided and how these costs may vary under different scenarios (e.g., at different levels of service, upon retirement, upon termination). Knowing and understanding the total cost of the executive compensation package is fundamental to a board of director's responsibility to ensure informed decisionmaking.

During our audit we reviewed Board meeting materials and other documentation and interviewed all 15 Board members to gain an understanding of the process the Board used to establish the former general manager's employment agreement and compensation package. Overall, we found that the Board entered into employment agreements and approved compensation elements for the former general manager without first obtaining critical cost data necessary to responsibly evaluate proposed contract terms. Although the Board generally knew the former general manager's base salary, salary increases, and monetary incentive payments, the Board did not compile these data to provide an overall cost picture for the total compensation package. Moreover, the Board lacked important cost data prior to approving the former general manager's retirement benefit, which was a key element of his total compensation package. As of February 1, 2010, the Pension Plan's contract actuary estimated that the lump-sum value of the former general manager's retirement benefit was about $2.9 million. Approximately $1.7 million of this total retirement benefit is attributable to the former general manager's higher service credit accrual rate in the Pension Plan.

As mentioned previously, in February 2001 the Board approved an employment agreement with the former general manager awarding him an accelerated rate of 2½ years of service credit in the Pension Plan for each year worked. The Board's decision to grant this additional retirement benefit resulted in a higher cost to the District. However, it was not until May 2001, more than two months later, that the Board received an actuarial estimate of the total cost of this additional retirement benefit or its effect on the Pension Plan. Moreover, we found that this actuarial estimate was based on outdated and incomplete salary information provided to the Pension Plan's contract actuary. The actuarial estimate was based on an adjusted base salary as of January 2000 ($159,600) that did not account for (1) base salary increases made in April 2000 and February 2001, or (2) monetary incentive payments and deferred compensation amounts that, according to the 2001 employment agreement, "are considered salary payments for retirement calculation purposes." We determined that the actuarial analysis should have used a total salary figure of about $230,500, approximately $70,900 more than the figure used to prepare the cost estimate. Due to these errors, the actuarial cost estimate provided to the Board in May 2001 understated the cost of the former general manager's additional retirement benefit. As of May 2001, the actuarial estimate of the additional retirement benefit was about $517,000. As mentioned previously, in February 2010, the actuarial estimate of the additional retirement benefit was about $1.7 million.

Ultimately, the full cost of the former general manager's retirement benefit could not be borne by the Pension Plan alone because the total benefit amount exceeded limits imposed by federal law. Section 415(b) of the Internal Revenue Code places a cap on the total annual benefit that can be accrued or paid to a participant under a qualified defined benefit plan, and the former general manager's annual retirement benefit exceeded this cap. Thus, in June 2005 the Board established a governmental excess benefit plan (Excess Benefit Plan) under Section 415(m) of the Internal Revenue Code to fund and pay that portion of the former general manager's retirement benefit that could not be legally paid from the Pension Plan. As of February 1, 2010, the Pension Plan's contract actuary determined that about $1.6 million of the former general manager's total defined retirement benefit of $2.9 million could be paid from the Pension Plan, leaving the remaining $1.3 million to be paid from the Excess Benefit Plan or the District's general assets.

To ensure accountability for compensation decisions, the Board must have a clear understanding of the total cost of proposed benefits prior to taking action. No board of directors should approve an executive compensation package or employment agreement without fully understanding its terms and potential costs. The Board should make use of formal mechanisms that facilitate the compilation and dissemination of cost data and other information pertaining to the general manager's employment agreement and compensation package. Faced with increased scrutiny of executive compensation, corporate boards have increasingly turned to "tally sheets" to compile and review data on their executive compensation packages. Essentially, a tally sheet is a matrix that compiles the details of all major components of executive compensation and their related costs to the organization. Tally sheets allow boards to examine compensation and benefits in their totality, as well as the relationships among various pay components. This comprehensive picture is especially important when basic benefit promises are outlined in the employment agreement, but their costs are not necessarily visible. The Board should use a tally sheet or similar mechanism to compile and review annually all major components of the general manager's employment agreement and their related costs. Annual updates would allow the Board to factor in any increases in base salary or earned monetary incentive payments. By using these best practices, the Board can ensure that it has a comprehensive view of the full cost of the general manager's total compensation package both before and after negotiating the employment agreement.

Recommendation No. 2:

The Regional Transportation District Board of Directors should obtain complete cost data on the terms of the general manager's employment agreement and total compensation package prior to making a decision to approve the agreement. Additionally, the Board should use a tally sheet or similar mechanism to compile and review annually all major components of the general manager's employment agreement and their related costs.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: Implemented and Ongoing.

The RTD has identified and calculated all costs for the new general manager's complete compensation. A clear methodology has been developed with the assistance of an outside independent auditing firm that specifically delineates all appropriate cost factors to ensure all costs are clearly identified for the entire compensation agreement. This methodology is designed to ensure that all costs associated with the new general manager's compensation are fully enumerated. Please note that the extra compensation measures identified by the State Auditor in the former general manager's contract—including accelerated pension service credit accrual, performance incentive pay, paid deferred compensation, and increased sick and vacation accruals—are not included in the employment agreement for the new general manager. The RTD chief financial officer will annually compile, review, and report to the Board the total costs of the general manager's employment agreement. This report will be subject to an annual audit by an external audit firm retained by the Board. A copy of the new general manager's contract, along with a copy of the comprehensive cost analysis performed by an external auditor, has been provided to the State Auditor.

Pay and Performance

Best practices suggest that executive compensation programs should connect the value of executives' compensation with the value they provide the organization in return. That is to say, there should be a strong relationship between executive pay and performance. Boards of directors forge this relationship by providing for ongoing and comprehensive reviews of chief executives' performance. Further, some boards of directors choose to encourage top performance through incentive pay, which is a common component in many executive compensation programs.

During our audit we reviewed the terms of employment agreements for the former general manager, as well as documentation of the Board's efforts to evaluate overall performance and to determine incentive payments for the former general manager. As discussed in the following sections, we found that the Board did not ensure a strong linkage between pay and performance for the former general manager. Specifically, we found that (1) the Board did not conduct routine and comprehensive performance evaluations for the former general manager and (2) the monetary incentive program that the Board made available to the former general manager was poorly implemented.

Performance Evaluation

The Board delegates significant authority and responsibility for managing the District's operations to the general manager. Thus, a comprehensive performance evaluation completed by the Board is critical for determining whether the general manager is fulfilling his or her job responsibilities and ensuring a strong relationship between pay and performance.

Prior to 2001, the former general manager's employment agreements called for an annual performance evaluation to be completed by the Board. This performance evaluation served as the basis for increases in base salary, as well as any other financial incentives paid to the former general manager. However, in approving the 2001 employment agreement, the Board completely eliminated any provision for an overall performance evaluation of the former general manager. Accordingly, the Board had not conducted a comprehensive performance evaluation of the former general manager since February 2000.

The Board's changes in the 2001 employment agreement had two negative effects on its ability to ensure a strong relationship between pay and performance. First, the Board lacked a means of tying increases in the former general manager's base salary to performance. Instead, the Board tied increases in the former general manager's base salary solely to a market comparison with five other transit agencies, as discussed earlier in this chapter. As the foundation for any compensation package, base salary should have a direct tie to performance evaluations. Established best practices in compensation call for the use of market analysis to set the salary range and midpoint for a position; however, performance evaluations should be the basis for increasing base salary and moving pay toward the established market midpoint.

Second, the Board focused its attention solely on evaluating the former general manager's performance relative to specific goals established as part of the monetary incentive program. That is to say, although the Board evaluated the achievement of goals for purposes of making monetary incentive payments, this did not constitute an overall comprehensive performance evaluation for the former general manager. Consequently, the Board did not evaluate and assess many dimensions that could be considered important to the general manager's overall performance in the position, such as operational responsibilities (e.g., service delivery, contracted services, and maintenance); administrative responsibilities (e.g., human resources, labor relations, Board relations, external relations, procurement, legal management, and information technology); and executive management (e.g., strategic planning, leadership, communication, and other personal qualities). In 2000 the Board hired a consultant to develop a broader evaluation process for the then-general manager. The consultant used input from Board members, District employees, and other stakeholders to develop a set of core competencies and standards that the Board could use as a framework for evaluating the performance of the general manager. However, the Board did not pursue any of the changes recommended by the consultant. These changes were abandoned with the adoption of the former general manager's 2001 employment agreement.

During our interviews several Board members stated their belief that the former general manager provided tremendous benefit and value to the District. However, without a comprehensive, ongoing, and well-documented performance evaluation process, such anecdotal assertions cannot be substantiated. The Board should ensure a strong relationship between pay and performance by annually evaluating the overall performance of the District's general manager. In accordance with established best practices, the Board should use the annual performance evaluation as the basis for increasing the general manager's base salary. The Board should establish performance standards and evaluation factors for the general manager that are comprehensive and highlight the core competencies and skill sets required to perform the job. As a starting place for identifying core competencies and skill sets, the Board should revisit the work performed by its consultant in 2000. Additionally, the Board should define a metric for each performance standard and evaluation factor to ensure consistent application of rating criteria. Once completed, the Board should provide the written performance evaluation to the general manager annually and maintain a copy in the general manager's personnel file.

Recommendation No. 3:

The Regional Transportation District Board of Directors should ensure a strong relationship between pay and performance by developing and implementing a formal process for annually evaluating the general manager's performance. At a minimum, the Board should:

a. Establish performance standards and accompanying evaluation factors that are comprehensive and highlight the core competencies and skill sets required to perform the job.

b. Define a metric for each performance standard and evaluation factor to ensure consistent application of the rating criteria.

c. Provide the written performance evaluation to the general manager annually and maintain a copy in the general manager's personnel file.

d. Use the annual performance evaluation as the basis for determining increases in the general manager's base salary.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: December 2010.

The former general manager's contract contained benefits that were provided to general managers of peer transit agencies, and was the result of more than a decade of exceptional performance, including securing nearly one billion dollars in federal funding, and the successful opening of three consecutive light rail lines on time and on budget with each exceeding ridership projections. Subsequent contract renegotiations were conducted in the context of repeated recruitments of the former general manager by other transit agencies at a time when the agency was in the midst of major transit projects and programs such as T-REX and FasTracks. The RTD's ability to maintain high levels of service and avoid methods, such as steep fare increases, slashing of service by up to 50 percent, and wholesale layoffs, that are being employed by other transit agencies clearly indicates superior overall management.

The Board recognizes that the specific methodologies used to evaluate the former general manager's performance could have been improved. Such improvements are directly reflected in the new general manager's contract. Specifically, the new general manager's contract calls for the Board to conduct an annual performance evaluation with the general manager. Based on this review and evaluation, the Board may increase the general manager's base salary by up to 5 percent. The first performance review is due by December 31, 2010. In comparison, since 2000 the former general manager was evaluated based on the achievement of five specific annual goals established as part of a monetary incentive program that no longer exists.

The procedures developed for the new general manager's annual evaluation are being revised and will include specific, quantifiable performance standards and goals. In addition to the overall District performance standards currently in place, any future additional goals specifically concerning the general manager will be designed to be clearly quantifiable and to address the core competencies expected by the Board. The Board will develop a specific evaluation method for each standard to consistently evaluate the performance of the general manager. While the Board did conduct annual salary evaluations for the former general manager, since 2000 those evaluations were to determine if goals were met for a monetary incentive program that has now been eliminated. The new general manager will receive comprehensive annual written evaluations on the basis of specific standards and goals. These comprehensive evaluations, along with any other relevant issues, will be included in determining future compensation increases. Copies of these annual evaluations will be maintained by the District in the general manager's personnel file.

Monetary Incentives

As discussed previously, boards of directors often choose to encourage top performance among senior executives in a more targeted manner through the use of incentive pay programs. A monetary incentive is different from a bonus. A monetary incentive focuses on motivating and rewarding desired behaviors and results based on pre-determined performance standards, whereas a bonus tends to be after-the-fact and discretionary.

Historically, the Board provided for a monetary incentive program as part of its employment agreements with the former general manager. For example, starting in 2001 the former general manager was eligible to receive an annual monetary incentive payment of up to 12.5 percent of his base salary—2.5 percent for each of five Board-established performance goals. Between 2001 and 2009, the District paid the former general manager a total of about $215,000 in monetary incentive awards.

Best practices in compensation demonstrate that a monetary incentive program can heighten the relationship between pay and performance. However, to do so, the monetary incentive program must have a clear purpose. That is to say, the goals, behaviors, and outcomes being incentivized must be distinguishable from the basic performance expectations of the job. Additionally, the process for setting and evaluating performance goals must be timely and well documented.

We reviewed the monetary incentive program established by the Board for the former general manager. Overall, we found that the monetary incentive program was poorly implemented. Specifically, the Board (1) did not clearly define the incentive program's purpose, or how the performance goals tied to incentive payments were different and distinguishable from the overall performance expectations for the general manager position, (2) was not timely in establishing the performance goals tied to the monetary incentive program or in evaluating the former general manager's achievement of these goals, and (3) was not consistent and thorough in its documentation and tracking of the performance goals tied to the monetary incentive program.

First, the Board was not clear in identifying the behaviors and performance it was attempting to motivate through the monetary incentive program. For example, since 2001, the performance goals tied to the former general manager's monetary incentive payments have ranged from very broad organizational goals tied to the District's strategic plan (e.g., increasing ridership, improving service quality, and improving on-time performance) to very narrow task-oriented goals (e.g., implement a web-based system for bus driver input regarding transit and customer services). However, these performance goals were developed piecemeal through each of the Board's committees and did not collectively represent a unified purpose for the monetary incentive program. Additionally, we identified a number of performance goals the Board established for the former general manager that did not appear appropriate for incentive payments, since these goals could reasonably be considered part of the position's basic job requirements. For example:

- A 2008 goal called for the former general manager to provide ample notice of all actions or issues requiring Board approval and to provide at least three viable alternatives, along with the advantages and disadvantages of each, for complex and controversial issues requiring Board approval.

- A 2006 goal called for the former general manager to develop a plan and cost estimate acceptable to the Board to strengthen light rail fare enforcement.

- A 2005 goal called for the former general manager to conduct a survey to gauge employee perceptions of the quality and performance of the District as a work environment.

- A 2004 goal called for the former general manager to hold at least three meetings in each director district to discuss District issues, including the District's FasTracks transit expansion project.

- A 2001 goal called for the former general manager to improve organizational effectiveness by mentoring senior staff and creating a productive District-wide work environment for all employees.

We question the appropriateness of the Board's rewarding the former general manager's achievement of each of these goals with an additional payment equal to 2.5 percent of his base salary. The activities that were incentivized can reasonably be considered a part of the general manager's normal job expectations.

During our interviews Board members also expressed concerns about the monetary incentive payments, including concerns that many performance goals were simply tasks that the former general manager was responsible for as part of his normal duties.

Second, the Board was not timely in establishing the performance goals tied to the monetary incentive program or in evaluating the former general manager's accomplishment of these goals. Specifically, the former general manager's employment agreements required that as part of the monetary incentive program, the Board, in consultation with the general manager, would establish performance goals by December 31 (December 1 under the 2007 agreement) of each calendar year preceding the performance year, and would evaluate achievement of the goals by December 31 of the performance year. We reviewed Board documentation of performance goals established and evaluated between 2001 and 2009 and found that in five of the years the Board did not set the former general manager's performance goals by the December deadline. In these five years, the Board was between one and five months late in establishing the performance goals. Additionally, in six of the years the Board did not evaluate the achievement of the previous year's performance goals by the December deadline. In these six years, the Board was between 1½ and 10½ months late in evaluating the achievement of the previous year's goals.

Finally, the Board was not consistent and thorough in its documentation and tracking of performance goals tied to the monetary incentive program. For example, the only documentation of the former general manager's 2005 performance goals was an email. In contrast, in other years we noted that performance goals for the monetary incentive program were outlined in a memorandum that the former general manager signed and returned to the Board. Additionally, evaluation of the achievement of goals was not adequately tracked and documented from one year to the next.

As a result of poor documentation practices and a lack of adherence to established time frames, we identified two instances in which the Board inadvertently paid the former general manager twice for meeting the same performance goal. Specifically, two goals in 2002 and 2003 called for the completion of tasks that were only accomplished in one year but not in both, yet incentive payments were awarded for accomplishing the goals in both years:

- A 2002 goal called for the former general manager to successfully negotiate with the collective bargaining unit for transportation services. In September 2003 the Board awarded the former general manager an incentive payment of about $5,350 for achieving the 2002 goal. However, this goal could not have been achieved in 2002 because the then-current collective bargaining agreement was not due to expire until February 2003 and no negotiation was necessary. The Board carried this same performance goal forward to 2003, and successful negotiations with the collective bargaining unit were completed in April 2003. In November 2004 the Board again awarded the former general manager an incentive payment of about $5,640 for achieving the 2003 goal.

- A 2002 goal called for the former general manager to complete a final FasTracks financial plan and corridor alignment and submit it to the Board for approval by June 2002. The former general manager completed this task, and the Board awarded him an incentive payment of about $5,350 for meeting the goal on time. The Board issued this same goal in the subsequent year with a deadline of June 2003, and again the Board awarded the former general manager an incentive payment of about $5,640. However, the former general manager did not submit another FasTracks financial plan and corridor alignment to the Board by June 2003.

The Board needs to reevaluate its monetary incentive program for the general manager. If the Board continues to make a monetary incentive program available, the Board should clearly define the program's overall purpose, as well as the behaviors it is attempting to motivate and the outcomes it is attempting to achieve. The Board should define how the performance goals tied to incentive payments are different and distinguishable from the overall performance expectations for the general manager. The Board must not blur the relationship between base salary and incentive pay by providing additional compensation to the general manager for performing functions, carrying out tasks, or achieving performance goals that could reasonably be considered standard performance expectations. The Board should establish a clear process for developing and vetting performance goals for the general manager. If the Board wishes to use its various standing committees to help develop goals, it should provide guidance to ensure that the performance goals developed by the committees will meet the overall objectives of the incentive program. The Board should establish the general manager's performance goals and evaluate their achievement in accordance with time frames established in the employment agreement. Finally, the Board should ensure that the entire process is well documented.

Designing and implementing an effective monetary incentive program requires planning and follow-through. Without critical design elements—including a clearly established purpose, a timely process for setting performance goals and evaluating their achievement, and thorough documentation—the Board lacks assurance that incentive payments are warranted or are achieving desired results. Consequently, the general manager's monetary incentive payments simply become discretionary bonus payments with few ties to performance.

Recommendation No. 4:

The Regional Transportation District Board of Directors should ensure a strong relationship between pay and performance by reevaluating the monetary incentive program for the general manager. If the monetary incentive program continues, the Board should:

a. Define the incentive program's purpose, including the specific behaviors and outcomes the Board is attempting to motivate and achieve.

b. Define how performance goals tied to incentive payments are different and distinguishable from the general manager's overall performance expectations and job responsibilities.

c. Establish a clear process for developing and vetting performance goals for the general manager, including prescribing guidance to ensure that the resulting performance goals will meet the overall objectives of the incentive program.

d. Develop performance goals and review their achievement in a timely manner as prescribed by the employment agreement. The entire process should be well documented in the general manager's personnel file.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: Implemented.

The careful stewardship of District assets, along with securing the highest quality leadership, has always been the goal and policy of the RTD Board of Directors and it will continue to carefully address all issues relating to senior executive compensation. The Board has reevaluated the monetary incentive program and has not included any provisions for performance incentive pay in the new general manager's contract. Thus, the remaining parts of this recommendation are not currently applicable. However, should monetary incentive payments be authorized for the general manager in the future, the Board will ensure that the principles outlined in this recommendation are followed.

Compensation Philosophy

Designing and implementing an effective executive compensation program can be a challenging task for a board of directors. The compensation package must contain the right mix of pay elements to attract, retain, and motivate the chief executive officer and at the same time be capable of withstanding public scrutiny. Boards of directors must also overcome the tendency to make decisions about executive compensation on a piecemeal basis and should instead pay attention to the role that each element plays in the context of the total compensation package. Corporate boards are increasingly recognizing the value of developing a compensation philosophy to provide an overall framework for the design, implementation, and evaluation of their executive compensation programs. Developing a compensation philosophy offers boards of directors the opportunity to consider views on target pay levels, the proper mix of pay elements and benefits, performance metrics and evaluations, and other compensation design issues.

Our audit found that the Board lacks a compensation philosophy, or framework, for guiding decisions about the general manager's employment agreement and total compensation package. Fundamentally, all of the concerns identified in this chapter are rooted in the absence of a compensation philosophy for designing and evaluating executive compensation. Instead of comprising a cohesive set of pay components within an overall compensation framework, the former general manager's compensation package represented a collection of individual pay components that were not tied together to achieve a clear purpose. For example, it is unclear whether the former general manager's compensation package was designed to accomplish any or all of the following purposes:

- Ensure competitiveness with executive compensation packages being offered by other comparable public transit agencies.

- Provide parity with compensation practices for other District employees.

- Create a strong linkage between performance and compensation.

Without a compensation philosophy, the Board lacks a clear framework to anchor and justify its compensation decisions and ensure accountability to taxpayers. Additionally, there are increased risks that executive pay will be set too high or too low, or fail to serve its overall purpose—which is to attract, retain, and motivate the District's general manager.

The Board needs to develop and adopt a compensation philosophy as a framework to guide all aspects of the general manager's employment agreement and compensation package. This framework should outline general guiding principles of total compensation and value, detail the purpose and rationale for specific compensation elements and the relationship between them, and establish the relationship between pay and performance. The Board should review its compensation philosophy on an annual basis and make appropriate revisions as the organization changes. To ensure that the Board receives the desired value over time, the Board should review its compensation philosophy concurrently with a review of data compiled annually via tally sheets on the cost of the general manager's total compensation package (see Recommendation No. 2) and the completion of the general manager's annual performance evaluation (see Recommendation No. 3).

The Board should also consider developing a compensation philosophy that extends beyond the general manager to include the District's other senior managers and employees. For example, boards of other organizations, such as the Colorado Public Employees' Retirement Association, have established compensation philosophies for the entire organization, not just senior executives. State statute [Section 32-9-114(1)(d), C.R.S.] vests the Board with the power to establish the compensation of all District officers, agents, and employees. The District's management has adopted a compensation philosophy for its salaried employees, which could serve as a starting point, should the Board decide to develop and adopt a comprehensive compensation philosophy for the District as a whole.

Recommendation No. 5:

The Regional Transportation District Board of Directors should develop and adopt a formal compensation philosophy as a framework to guide the design, implementation, and evaluation of the general manager's employment agreement and compensation package. At a minimum, the Board should:

a. Ensure that the compensation philosophy outlines general guiding principles on total compensation and value, details the purpose and rationale for specific compensation elements and the relationship between them, and establishes a clear relationship between pay and performance.

b. Review the compensation philosophy and make appropriate revisions on an annual basis. This review should be performed concurrently with a review of data compiled annually on the cost of the general manager's total compensation package and the completion of the general manager's annual performance evaluation.

c. Consider developing and adopting a comprehensive compensation philosophy that extends beyond the general manager to include the District's other senior managers and employees.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: October 2010.

Compensation procedures have been revised with the hiring of the new general manager. The Board will continue to review and refine these procedures to ensure the general manager's compensation is continually monitored and comprehensively reviewed on a periodic basis.

a. The compensation for the new general manager's contract is now directly connected with the compensation processes for the District's salaried employees as a whole. The Board is developing a detailed set of procedures that address total compensation and value to ensure these elements are connected to specific criteria. This is a result of the Board's compensation philosophy for the general manager that is now consistent with what the salaried employees of the District receive.

b. The Board is developing a comprehensive review process for the general manager's compensation through the newly formed General Manager Oversight and Performance Management Committee, and will perform and document an annual evaluation of the process that will be utilized as part of the general manager's annual performance evaluation. If the review warrants, appropriate compensation changes will be made and will be clearly documented and costed out.

c. The Board agrees that the compensation of all District salaried employees must be fair and reasonable, and the Board does approve the number of salaried employee positions and their attendant salaries each year, first in the annual budget and again in the amended budget. For salaried employees, the District has for many years utilized an annual salary survey of comparable positions at public agencies and private businesses, conducted by Mountain States Employers Council, to evaluate compensation practices. This survey, plus a survey conducted by internal staff of transit-specific jobs, is the basis for annual adjustments, if called for, to the salaried employee grade ranges. The responsibility for actually implementing the District's compensation practices, as approved by the Board as part of the annual budget, directly lies with the general manager. As recommended, the Board will adopt a more comprehensive compensation philosophy that extends to senior managers and salaried employees. As noted elsewhere by the State Auditor, for the second consecutive year the RTD salaried staff has not received merit increases due to the economic recession. The Board believes the human relations policies and procedures developed by the District are well structured and continue to attract the highly qualified and dedicated staff that has made RTD one of the most respected transit organizations in the country, as evidenced in part by RTD being named by the American Public Transportation Association as the best transit agency in the country in 2008 for a record-tying third time. The agreement with the new general manager is directly tied to the benefits and procedures associated with all RTD salaried employees, as the general manager is not eligible for any benefit on a basis more favorable than that generally applicable to all of the District's employees.

Board Oversight and Governance

Chapter 3

As we described in Chapter 1, the Board relies on the general manager to manage the District's day-to-day affairs and operations. The general manager's responsibilities include managing the District's employees, executing the District's annual budget, making recommendations to the Board regarding District operations, interpreting and implementing District policies, and fulfilling other duties as assigned by the Board. Given these sizable expectations, one of the Board's most important responsibilities, as discussed in Chapter 2, is to hire the general manager and establish his or her employment agreement and compensation package.

However, the Board's responsibility as an employer does not end upon hiring the general manager and determining his or her compensation. The Board has a responsibility to provide ongoing oversight over the general manager. As a government entity that relies on tax dollars as a major source of revenue, the Board also has a responsibility to ensure stewardship and accountability for the use of public funds and provide for an effective system of oversight and governance over District operations and the Board's own activities.

Overall, we found that the Board largely neglected its oversight and governance responsibilities in several key areas once the former general manager was hired. Specifically, the Board: (1) was not sufficiently transparent with the public about the former general manager's employment agreement and compensation package, (2) did not actively manage the employment agreement to ensure adherence to its provisions, and (3) did not provide sufficient review of business expenses to ensure they were allowable and properly substantiated. Additionally, we identified a number of changes the Board could make to ensure more efficient and effective governance and, therefore, fulfill its broader oversight responsibilities.

Public Transparency

As government entities, both the Board and the District are responsible for ensuring public transparency in their activities. Thus, the public must be afforded the opportunity to review pertinent information that serves as the basis for decisions. The Board and the District have three existing mechanisms available to disclose information about compensation decisions to the public: (1) the former general manager's employment agreement, which is a public document; (2) the District's financial statements, which are public documents and audited by the District's external auditor; and (3) the Board's meetings, which are open to the public and recorded in minutes. As we describe in this section, we identified ways in which each of these existing mechanisms could be used more effectively to ensure transparency and provide complete information about the general manager's employment agreement and compensation package to the public.

Employment Agreements

The employment agreement is the single legal document that outlines the terms of the general manager's employment and his or her compensation. Historically, the District has made the former general manager's employment agreements available to the public through open-records requests. Although the employment agreements set forth the contractual compensation and benefit requirements, the employment agreement alone does not adequately communicate the full cost of the general manager's compensation package. For example:

- The 2001 employment agreement and subsequent agreements disclosed that the former general manager was provided with an accelerated service credit accrual rate in the Pension Plan. However, additional information from the District about employer contributions to the Pension Plan and the Excess Benefit Plan is needed to calculate the full value of this retirement benefit. As discussed in Chapter 2, even the Board itself did not have complete information on the full cost of the former general manager's retirement benefit. The District's contract actuary estimated that the lump-sum value of the former general manager's retirement benefit was about $2.9 million as of February 1, 2010.

- The 2001 employment agreement and subsequent agreements disclosed that the District would make the maximum annual contributions permitted by law into the 457 Plan on the former general manager's behalf. However, only by reviewing the Internal Revenue Code could one learn the amount of this maximum contribution. According to the Internal Revenue Code, the maximum contribution in 2009 for an employee over age 50 was $22,000.

It may not be possible to outline the full cost of the general manager's total compensation package in his or her actual employment agreement. For example, the amount of employer contributions to benefit plans can change from year to year. This is why the Board should rely on tally sheets or a similar mechanism to compile and review the cost of the general manager's total compensation package (see Recommendation No. 2). Once compiled, this comprehensive cost information should also be communicated to the public. Fortunately, tally sheets are easily disseminated. Alternatively, the Board could prepare an annual disclosure statement designed for public consumption, similar to the proxy statements that publicly traded companies prepare for shareholders. For example, the U.S. Securities and Exchange Commission requires such proxy statements to disclose each element of executive compensation, as well as how the company determines the amount and, where applicable, the formula for each element of pay.

Financial Statement Disclosures

Financial statements and the related note disclosures are an integral part of public reporting about an organization's financial position and performance. Generally accepted accounting principles require organizations to include certain information and disclosures as part of their prepared financial statements. Additionally, organizations can use their financial statements to fulfill a broader reporting purpose by providing information about substantively important issues, such as executive compensation, even when such information is not necessarily material to the financial statements or required to be disclosed under applicable accounting standards.

During our audit we reviewed the audited financial statements for the District and the Pension Plan and found that these documents did not provide information about the unique retirement and deferred compensation benefits contained in the formal general manager's employment agreement. In other words, one would be unaware from reading the District's and the Pension Plan's financial statements that the District's former general manager received retirement and deferred compensation benefits that differed from those offered to other salaried employees. For example:

- The District's financial statements for Fiscal Years 2005 through 2008 contained no information about the Excess Benefit Plan. As discussed in Chapter 2, in January 2005 the District established the Excess Benefit Plan to fund the portion of the former general manager's defined retirement benefit beyond what could legally be paid from the Pension Plan. Because the Excess Benefit Plan plays a key role in funding the former general manager's defined retirement benefit, the District could have provided more complete information to the public by including details about the Excess Benefit Plan as part of the financial statement disclosure regarding employee retirement plans.

- In two instances, financial statement disclosures did not include benefit provisions that were unique to the former general manager. First, the District's Fiscal Year 2008 financial statements included a disclosure about the existence of the District's 457 Plan (which permits employees for tax purposes to defer a portion of their compensation to future years) and that employees make their own elective contributions to the 457 Plan. However, the disclosure did not state that the District has been contractually obligated since 2001 to make contributions to the 457 Plan on the former general manager's behalf. Second, the Pension Plan's

Fiscal Year 2008 financial statements (which are prepared by the Pension Plan and not the District) included a disclosure about service credit accruals for Pension Plan participants. However, the disclosure did not state that the District's former general manager accrued service credit at a rate 2½ times that of other plan participants. Given the sensitivity of issues around executive compensation, the District and the Pension Plan could have provided more complete information to the public by including these unique benefit details as part of the note disclosures in their respective financial statements.

As discussed previously, financial statements can be used to provide public transparency about substantively important issues, such as executive compensation. Financial statements and the related note disclosures are the responsibility of management. Therefore, going forward, any unique benefits provided to a District employee, group of employees, plan participant, or group of plan participants should be completely and accurately disclosed in the District's and the Pension Plan's respective financial statements. To the extent that any unique benefits are still being paid or provided to the former general manager, such information should also be disclosed. The purpose of our audit was not to review or express an opinion on the District's or the Pension Plan's financial statements or to determine compliance with generally accepted accounting principles; doing so is the responsibility of the District's and the Pension Plan's external auditor.

Public Meetings

During our audit we noted that much of the Board's discussions about the details of the former general manager's employment agreement and compensation package took place during executive sessions, which are not open to the public. It is important that the Board has the ability to meet privately, especially during active contract negotiations. Personnel matters and contract negotiations are appropriate uses of executive session under Colorado's Open Meetings Law [Section 24-6-401, et seq., C.R.S.]. However, the Board's use of executive session during active negotiations does not diminish its responsibility to ensure transparency once the general manager's employment agreement has been agreed upon and executed. Specifically, we reviewed Board meetings, recordings, minutes, and agendas related to the former general manager's 2007 employment agreement—the most recent agreement negotiated between the Board and the former general manager. We found no evidence that the Board discussed in open meeting the dollar value of the total compensation package or the rationale for the pay elements it approved. We found that the committee overseeing the negotiations discussed costs associated with certain provisions in the employment agreement; however, such detailed discussions occurred only in executive session.

Open meetings provide a forum for communication and are a primary means through which the public can gain access to information and decisionmakers.

Following best practices in executive compensation among corporate boards, we identified ways in which the Board could more effectively communicate in open meeting so that the public has access to important information regarding the general manager's employment agreement and compensation package. Specifically, the Board should ensure routine and thorough communication about the general manager's employment agreement and compensation package through its compensation committee (see Recommendation No. 12). The chair of the Board's compensation committee should provide an update at every Board meeting regarding key committee activities, as well as decisions requiring formal action by the Board. Simply submitting the compensation committee's meeting minutes to the other Board members is insufficient for communicating information to the public. Once each year, the compensation committee should provide a briefing to the full Board in open meeting that covers in detail key compensation issues, such as the terms of the employment agreement and associated cost data, how pay is set, benchmarking efforts, how the peer group is developed, how monetary incentive payments work, and how performance goals are set and evaluated.

Recommendation No. 6:

The Regional Transportation District Board of Directors should ensure transparency with respect to the general manager's employment agreement and compensation package by:

a. Providing the public with comprehensive cost information by disseminating tally sheets or another cost summary statement designed for public consumption.

b. Obtaining an update at each Board meeting regarding key compensation committee activities.

c. Holding an annual briefing, in an open meeting, that covers in detail the various components and associated costs of the general manager's employment agreement and compensation package.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: October 2010.

The Board of Directors of the RTD will continue to be transparent in all its operations and will continue to provide complete and open access to all legally permissible compensation information. The Board will expand these efforts and review procedures to increase and improve the dissemination of information.

a. The Board has developed a more specific itemization of all compensation and benefits being provided to the new general manager with costs identified for each. In addition, the Board will provide to the public, as permitted by law, the cost summary statements that itemize compensation and benefits provided to the new general manager.

b. Procedures will be improved to increase documentation to help ensure that all compensation amounts and any potential future amounts of compensation earned or due the new general manager are fully documented and provided to the Board as appropriate. The new General Manager Oversight and Performance Management Committee will meet regularly in open session, as permitted by law, and minutes of those meetings will be included in the Board meeting packets and will be presented in open session at the subsequent Board meeting.

c. As part of the general manager's annual evaluation, the Board will add to its normal open session contract review process the review and discussion of all applicable elements of the general manager's compensation, as permitted by law, in an open session meeting. As previously noted, the General Manager Oversight and Performance Management Committee will meet regularly in open session, as permitted by law, minutes of those meetings will be included in the Board meeting packets and will be presented in open session at the subsequent Board meeting. While the Board did previously discuss and present information regarding the former general manager's contract in open session, this more formal process will further ensure all Board members and the public are more fully briefed on current general manager compensation issues, as well as developments which could affect future negotiations.

Recommendation No. 7:

The Regional Transportation District should completely and accurately disclose in its financial statements any unique benefits provided to a District employee or group of employees. To the extent that any unique benefits are still being paid or provided to the former general manager, such information should also be disclosed.

Regional Transportation District Response:

Agree. Implementation date: May 2010.

The District will review employee and employee group contracts and determine if there are any employees or employee groups receiving additional unique benefits. The District will review the future disclosures related to the District's financial statements to determine if it is appropriate that such disclosures be enhanced to include information regarding any identified unique employee benefits. Any unique benefits or payments being made in the applicable calendar year to a unique employee or employee group identified as part of this review will be appropriately disclosed.

Recommendation No. 8:

The Regional Transportation District Salaried Employees' Pension Trust should completely and accurately disclose in its financial statements any unique retirement benefits provided to a plan participant or group of plan participants. To the extent that any unique retirement benefits are still being paid or provided to the Regional Transportation District's former general manager, such information should also be disclosed.

Regional Transportation District Salaried Employees' Pension Trust Response:

Agree. Implementation date: May 2010.

The Regional Transportation District Salaried Employees' Pension Trust ("the Trust") will review all Pension Plan documents and related disclosures associated with the annual financial statements and determine if any participants or groups exist regarding the provision of unique pension benefits. The Trust will review the Pension Plan's financial statements to determine if it is appropriate that the disclosures be enhanced to include information regarding unique benefits for any identified pension participant or group. Any unique benefits or payments being made in the applicable calendar year to a participant or participant group identified as part of this review will be appropriately disclosed.

Contract Management

The general manager's employment agreement is a legally binding contract executed between the Board and the general manager. This contract outlines the services the general manager is expected to provide and the Board's remuneration of the general manager for providing these services. It is critical that the Board actively oversee and manage this contract to ensure adherence to its provisions.

During our audit we reviewed the Board's and the District's management and execution of the terms of the former general manager's employment agreements since 2001. As we describe in the following sections, we found a lack of controls to ensure that compensation calculations were accurate and that the contract language accurately reflected the agreed-upon terms.

Calculations. We identified several instances in which incorrect applications of provisions outlined in the employment agreement resulted in under- or overpayments to the former general manager.

- Since 2001 District staff used a calculation different from the one described in the employment agreement to calculate increases in the former general manager's base salary. Moreover, the staff person who performed this calculation received direction on the calculation from the former general manager. This error resulted in a total underpayment of about $1,800.

- The Board calculated the former general manager's 2003 and 2004 monetary incentive payments using the subsequent year's base salary instead of the base salary that was in effect during the performance year (i.e., 2002 and 2003, respectively). This error resulted in a total overpayment of about $2,100.

- In 2005 the Board awarded the former general manager a monetary incentive payment of 10 percent of his base salary. Since he had met all five of his 2004 performance goals, the former general manager was eligible for a payment equal to 12.5 percent of his base salary. This error resulted in a total underpayment of about $5,600.

- In 2002 the District did not contribute the full amount required under the employment agreement into the District's 457 Plan on the former general manager's behalf. This error resulted in a total underpayment of about $1,000.

Employment agreement language. We identified one instance in which language contained in the employment agreement did not accurately reflect terms mutually agreed upon by the Board and the former general manager. Specifically, since 2001 the former general manager was eligible for an annual monetary incentive payment of up to 12.5 percent of his base salary. The District paid these monetary incentive payments as one-time payments that did not result in percentage increases in the former general manager's base salary. Board members and District staff reported that this practice was consistent with the terms agreed upon between the Board and the former general manager. We found, however, that the actual language of the employment agreements specified that each performance goal the former general manager achieved was to be rewarded by an increase of 2.5 percent of his base salary. Although the one-time payments reflected the understanding of the parties and there were no errors in amounts paid to the former general manager as a result of this issue, this example illustrates the need for more thorough review of the contract language.

Each of the problems we identified resulted from a lack of controls in place at the Board and District staff levels. The Board is responsible for overseeing and managing the general manager's employment agreement. Thus, the Board should develop a process with assigned accountabilities for reviewing and approving all compensation calculations for the general manager's contract to ensure their accuracy, completeness, and adherence to the terms of the employment agreement. In some cases, District staff who report to the general manager may be responsible for performing compensation calculations. To avoid a potential conflict of interest or the appearance thereof, the Board should ensure that such calculations are reviewed by an individual outside the general manager's reporting line, such as staff in the Board's administrative office, internal audit staff, or the chair of the Board's compensation committee, prior to final approval by the Board Chair. Additionally, the Board should work with its general counsel to ensure that the final language of the employment agreement accurately reflects mutually agreed-upon terms.

Recommendation No. 9:

The Regional Transportation District Board of Directors should improve controls at the Board and staff levels to ensure more effective oversight and management of the general manager's compensation package and employment agreement. At a minimum, the Board should:

a. Develop a clear process with assigned accountabilities for reviewing and approving all compensation calculations for the general manager's contract. Compensation calculations performed by District staff who report to the general manager should be reviewed by an individual outside the general manager's reporting line, such as staff in the Board's administrative office, internal audit staff, or the chair of the Board's compensation committee, prior to final approval by the Board Chair.

b. Work with the Board's general counsel to review the final language of the general manager's employment agreement and ensure that it accurately reflects the terms mutually agreed upon by the Board and the general manager.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: Implemented and Ongoing.

a. The District has now hired a new general manager and has significantly revised compensation practices, as reflected in the new contract. All issues concerning the contract for the newly hired general manager will continue to be carefully reviewed and monitored as part of the Board's continuing responsibilities and revised compensation policies. This contract is directly tied to the general payroll structures of the entire District. The District's chief financial officer will annually review all compensation aspects of the general manager's contract, and report findings to the Board. An external auditor will be retained by the Board to annually review the financial aspects of the general manager's contract and report findings directly to the Board.

b. The District's general counsel will continue to be utilized to review the agreement and ensure it accurately reflects the agreed-upon terms. For the new general manager's contract, the Board brought in an outside attorney who specialized in employment law to negotiate on behalf of the District, and the Board will utilize this process in the future as needed.

Business Expenses

The former general manager's employment agreement provided for the reimbursement of business expenses. Additionally, the District has established policies and procedures for the reimbursement of business expenses incurred by other District staff. Compliance with such policies and procedures is essential to ensure that business expenses are allowable, appropriate, and properly substantiated.

During our audit we reviewed a non-statistical sample of 114 expense reimbursement and purchasing card transactions made by the former general manager and 13 other senior managers during Calendar Year 2008. These 114 expense reimbursement and purchasing card transactions totaled about $56,100.

Overall, we identified unallowable expenses and/or insufficient supporting documentation for a total of 31 transactions, yielding a 27 percent error rate. These exceptions affected about $2,600, or 5 percent, of the total dollars we reviewed. Some transactions had more than one problem.

- **Unallowable expenses for 11 transactions totaling $450.** First, we identified eight transactions totaling $401 for mileage, tolls, and parking at Denver International Airport. To encourage employees to use the District's SkyRide bus service, District policy prohibits reimbursement of travel expenses to and from the airport. The only exception to the policy is when the return flight arrives after the last SkyRide bus for the day has left; however, none of the eight exceptions we found met this requirement. Second, we identified two transactions totaling $45 for long-distance telephone calls charged to a hotel room. District policy permits long-distance phone calls only through use of the District's telephone card; employees who do not request a telephone card are not permitted to claim reimbursement of their long-distance calls. Finally, we identified one transaction for meal expenses that exceeded daily limits by a total of $4. District policy limits reimbursement for personal meals and gratuities to $50 per day.

- **Insufficient supporting documentation for 25 transactions totaling $2,167.** First, we identified 10 transactions, totaling $1,225 for business meetings, that lacked sufficient documentation of the meeting's purpose or attendees. District policy requires that supporting documentation describe the meeting's purpose and list the names and positions of participating individuals. Second, we identified 12 transactions, totaling $891 for meals, that lacked itemized receipts. District policy states that receipts lacking itemized purchase details will not be accepted for reimbursement. Finally, we identified three transactions for other purchases totaling $51 that had no receipts supporting the expenditure.

District policy assigns the employee's immediate supervisor the responsibility for reviewing and approving business expenses to ensure compliance with District policies and procedures. In the case of the general manager, we noted five expense reimbursements that had not been approved by the Board Chair and seven travel authorization forms stating only that the Board Chair had verbally approved the travel. In the case of other senior managers, we noted four expense reimbursements that had not been approved by the former general manager or his designee.

We are concerned that our review of senior managers' business expenses yielded such a significant error rate. All employees, including the general manager and senior managers, have a responsibility to understand and comply with established policies and procedures when using the District's purchasing card or claiming reimbursement of business expenses. Adherence to financial policies and procedures is particularly important for the District's senior management, who set the tone for the whole organization.

The Board and the District need to provide more thorough review and approval of the general manager's and other senior managers' business expenses and purchasing card statements to ensure compliance with District policies and procedures. For example, the general manager's expense reimbursements and purchasing card statements should be routed through the Board's administrative office for review and approval by the Board Chair. Additionally, the general manager and assistant general managers should be more diligent when reviewing and approving business expenses for the assistant general managers and other senior managers, respectively. If a deviation from established policies and procedures is permitted, the deviation and reason for it should be identified and approved separately.

Recommendation No. 10:

The Regional Transportation District Board of Directors and the Regional Transportation District should improve internal controls to provide for more thorough review and approval of the general manager's and other senior managers' business expenses and purchasing card statements to ensure compliance with District policies and procedures. Permitted deviations from established policies and procedures, as well as the reasons for such deviations, should be identified and approved separately.

Regional Transportation District and Board of Directors Response:

Agree. Implementation date: Implemented.

Both the Board of Directors and the District staff have developed updated methods to improve internal controls over business expenses. These updated procedures and policies better address the current climate and conditions associated with business travel and the related expenses. Specific business-related policies have been reviewed and revised to ensure they more clearly outline and delineate District procedures. Documentation standards for all business expenses will be enforced and full documentation will be required of all employees. Additional approval procedures or acknowledgements for specific, authorized exceptions to general policies are part of the updated procedures.

Board Governance

The corporate accounting scandals and financial crises that bookended the last decade offer many lessons, including the importance of effective board governance. This report has discussed a number of gaps and critical missteps related to the former general manager's employment agreement and compensation package. Lack of effective governance and oversight by the Board was a key contributing factor to all of the problems identified during our audit. We have made a number of recommendations for change that will strengthen the Board's management of the general manager's employment agreement and provide the taxpayers with more transparency and assurance that the general manager's total compensation package is appropriate and receives due consideration and scrutiny by the Board.

As discussed in the following sections, there are a number of additional changes the Board could make to ensure more efficient and effective governance and, therefore, better carry out its broader oversight responsibilities. These changes include ensuring the independence of internal audit, establishing a strong committee structure, developing a comprehensive self-governance manual, engaging in succession planning, and leveraging other available resources.

Internal Audit

Currently the District has an established internal audit function with two internal auditor positions. The internal audit function can be an indispensable part of overseeing an organization's operations. However, to perform effectively, the internal audit function must be organizationally independent from management.

We found that the District's internal audit function is not sufficiently organizationally independent from management to provide the maximum benefit to the Board in fulfilling its oversight responsibility. For example, the internal audit unit reports to the general manager through the assistant general manager for public affairs. Internal audit staff develop an annual audit plan with input from many sources, including the Board; however, the general manager retains final approval of the audit plan. Audit reports are submitted to the general manager, with only summary reporting to the Board on a quarterly basis. The general manager and assistant general manager for public affairs are responsible for the internal audit manager's performance evaluation. The internal audit manager is included as part of the overall compensation system established for the District's salaried employees, which allows for merit increases in salary based on performance.

As the governing entity responsible for overseeing District management, the Board should improve the organizational independence of the District's internal audit function consistent with professional standards in internal auditing as outlined by the Institute of Internal Auditors. Overall, improving organizational independence requires the Board to redefine the functional reporting line and associated activities for the internal audit unit.

Functionally, the District's internal audit unit should report to the Board through an established audit committee. (We discuss the Board's committee structure in the following section.) Functional reporting means, among other things, that the audit committee should have final authority to review and approve the annual audit plan and all major changes to the plan. The audit committee should receive routine communications on the complete results of internal audit activities. The internal audit director should have open and direct access to the audit committee and, when necessary, the Board Chair and the full Board. This should include the ability to meet without management present. Internal audit staff are included in the District's overall personnel and compensation system. However, as part of the functional reporting relationship, the audit committee should review and approve decisions regarding the appointment and removal of the internal audit director, as well as his or her compensation. At least once per year, the audit committee should evaluate the internal audit director's performance and approve any associated salary adjustments. Finally, in consultation with the internal audit director and senior management, the audit committee should also review and approve a summary of the internal audit unit's work schedule, staffing plan, and financial budget to ascertain whether the internal audit unit's activities support those of the organization and the Board.

We did not identify concerns with the current administrative reporting relationship between the internal audit unit and the District's assistant general manager of public affairs. Nonetheless, the Board should revisit this administrative reporting line as part of redefining the internal audit unit's functional reporting relationship. Administratively, the District's internal audit unit should report to the general manager or another senior manager with sufficient authority to provide the internal audit unit with the necessary support in the areas of human resources, accounting, and organizational policies and procedures to accomplish its day-to-day activities. Individuals in the administrative reporting line should not have authority over the scope or reporting of results for the internal audit activity. Budgetary controls and considerations imposed by the administrative reporting line should not unduly impede the ability of the internal audit function to accomplish its mission. The internal audit director should be able to communicate directly with any level of management, including the general manager.

Committees

Similar to other governing bodies, the Board relies on a number of different committees and subcommittees to accomplish its business. Committees are important for helping to manage the Board's workload because they establish a division of labor and allow Board members to develop subject-matter expertise. Currently the Board's bylaws establish six standing committees. The Board also has a number of ad hoc committees that the bylaws allow the Board Chair to create as needed. We identified three areas in which the Board could improve its committee structure to ensure accountability, an adequate division of labor, and subject-matter expertise.

First, although the Board's bylaws provide a basic description of each standing committee, none of the Board's standing committees or ad hoc committees has a charter. Committee charters are important for establishing mutual understanding among the Board, committee members, and District management about the scope of the committee's functions and accountabilities. For each standing committee, the Board should adopt a charter that clearly establishes the committee's jurisdiction, purpose, role and responsibilities, membership, subcommittees, operating procedures, and reporting requirements. For each ad hoc committee, the Board should adopt a more limited charter that, at a minimum, establishes each committee's jurisdiction, purpose, and role and responsibilities. Each committee should annually evaluate its performance against its charter and report to the Board with any recommendations for changes to the charter.

Second, the Board does not have a standing compensation committee or a standing audit committee. Historically, all Board activity related to the former general manager's employment agreement, compensation package, and performance evaluation was coordinated through an ad hoc committee. The Board's recent search for a new general manager was also coordinated through an ad hoc committee. In terms of the audit function, the Board's bylaws state only that the Administration and Finance Committee will have an audit subcommittee; the bylaws do not provide any further description of the audit subcommittee's responsibilities. The Board should follow best practices in corporate governance and establish a standing compensation committee and a standing audit committee, including a requirement that both committees provide routine updates to the Board. Doing so would elevate the importance of two Board functions that are critical for effective governance. The compensation committee should be responsible for coordinating Board activities and making recommendations for Board action regarding all aspects of the District's executive compensation program. The compensation committee's responsibilities should include those discussed throughout this audit report, such as developing an executive compensation philosophy, overseeing the general manager's employment agreement and total compensation package, establishing performance goals and evaluating the general manager's performance, and managing the succession planning process. Audit committees typically operate at the intersection between an organization's board of directors, management, internal audit, and external auditors. Accordingly, the Board's audit committee should be responsible for overseeing all audit-related activities designed to evaluate the quality and integrity of the District's accounting, financial reporting, and internal controls. This responsibility should include oversight of the independent audit of the District's financial statements, with sole authority to retain and set the compensation for the District's external auditor, as well as oversight of the District's internal audit function, as discussed previously.

Finally, the Board's propensity to use the "committee of the whole" structure may reduce the Board's efficiency and limit Board members' ability to gain specialized expertise. Committee of the whole is a device whereby all members of a governing body operate as one large committee. According to the Board's bylaws, all standing committees, with the exception of the Board's executive committee, will operate as committees of the whole. In effect, all committee business comes before the full Board, which can undermine the efficiencies gained by having a division of labor. Additionally, having a dedicated committee membership is a primary means by which Board members can develop subject-matter expertise. However, the Board's bylaws state that when operating as a committee of the whole, a quorum is reached with five members participating. This could apply to any five Board members, which means there is no guarantee that the same members are always involved in deliberating or studying an issue that comes before a particular committee.

Committees of the whole can be useful as a means of accomplishing certain aspects of the Board's business. For example, during our audit District staff and Board members reported that the committee of the whole structure affords every member the opportunity to be involved in standing committees' business, thereby providing for more open participation by Board members, greater information sharing, and expedited decisionmaking. However, given the potential disadvantages discussed previously, the Board should reevaluate its use of the committee of the whole as the primary means of organizing the Board's standing committees and committee activities.

Although Board members receive a $12,000 annual stipend authorized under state statute [Section 32-9-117(2), C.R.S.], many Board members have other full-time careers. Statute also does not require Board members to possess specialized expertise. Given these realities, ensuring that the Board's committee structure provides for an adequate division of labor and subject-matter expertise is important for increasing the efficiency and effectiveness of the limited time that individual members may have available to devote to Board activities.

Governance Manual

A strong self-governance framework is essential to ensuring that boards of directors fulfill their roles successfully. A written governance manual describes the framework within which boards of directors operate to set policy and oversee management operations and functions.

State statute enumerates the powers and duties of the District, all of which are vested in the Board. Additionally, the Board operates under bylaws and a compilation of Board resolutions that provide general guidance for how the Board's governance will be constructed (e.g., standing committees, ad hoc committees, election of Board officers) and how the Board will conduct business (e.g., posting notice of meetings, annual budgeting). However, the Board lacks a comprehensive governance manual that expands upon the existing statutes and bylaws to provide detailed guidance to the Board and its members.

The Board should develop a written governance manual to facilitate the organized, efficient, and cohesive functioning of the Board in fulfilling its responsibilities. Once developed, the manual should be annually reviewed and updated by the Board. The governance manual should serve as a resource and frame of reference for new and experienced Board members alike. For example, the manual should describe the roles and responsibilities of the major decisionmaking bodies involved in the governance and management of the District, including the Board, Board officers, Board committees and subcommittees, and the general manager. The governance manual should also contain policies and procedures that provide specific direction and guidance in a variety of key areas. These key areas should include Board members' roles and responsibilities; applicable standards of behavior; strategic planning, budgeting, and policy development processes; executive compensation and performance evaluation; succession planning; expense reimbursements; and contracting with external consultants.

Succession Planning

Succession planning is a process designed to help organizations weather inevitable changes in executive leadership by maintaining continuity of operations and decisionmaking until the transition to new leadership has taken place. Succession planning involves developing internal personnel to move into a vacant position, either temporarily or permanently, while also providing a clear process and timeline for conducting an external search.

During our interviews, several Board members attributed the ever-increasing compensation for the former general manager to a belief among Board members that the District could not afford to lose him. Certainly, retention is an important consideration in formulating a compensation package. However, the Board places itself at a disadvantage by negotiating an employment agreement without properly planning for the potential loss of the general manager. Even with a well-balanced compensation package, it is unreasonable to expect that a general manager will remain in perpetuity.

Board members reported during our audit that the Board had attempted to engage in succession planning activities in the past; however, these efforts were abandoned due to opposition by the former general manager. Although succession planning is more effective with participation from current leadership, proper succession planning for the general manager position is ultimately the Board's responsibility and prerogative. As of the end of our audit, the Board has completed a search process and named a new general manager. The Board should use these recent events as an opportunity to identify lessons learned and work with its new general manager to develop a succession plan for the general manager position and other senior management positions that are critical to the District's operations.

Other Board Support

As discussed previously, the Board must rely on support from a number of different sources in performing its oversight function. Two key areas of additional Board support that provide a degree of separation from District management are (1) the administrative staff of the Board Office and (2) the Board's ability to contract directly with external consultants and expert advisers.

Currently the Board Office has three full-time staff (an executive manager, an analyst, and an administrative assistant) who report directly to the Board. These Board Office staff manage all the administrative activities and functions of the Board, such as coordinating the flow of information and documentation to the Board and documenting and keeping records of Board actions and policies. However, there may be additional opportunities for the Board to draw support from the Board Office, especially in the area of managing the general manager's employment agreement. For example, Board Office staff could review business expenses, ensure that the Board meets performance evaluation time frames, serve as a point of contact for information compiled by District staff pertaining to salary increases and performance goals, and maintain the general manager's central personnel file. Additionally, the Board could take more advantage of its ability to contract directly with consultants and subject-matter experts for information and advice. For example, during our review of past Board meeting materials we noted instances in which Board members had expressed their belief that the Board needed to obtain additional outside expertise to assist with the former general manager's employment agreement and compensation package, yet no action was taken to obtain outside expertise.

The Board should leverage those resources and supports already available to help with its decisionmaking and oversight. The Board should identify opportunities to draw additional support from the Board Office. Further, the Board should act on its authority to contract directly with consultants and subject-matter experts when necessary.

Recommendation No. 11:

The Regional Transportation District Board of Directors should improve the organizational independence of the District's internal audit function by redefining the internal audit unit's functional reporting line and associated activities in accordance with established professional standards in internal auditing. As part of this process, the Board should also review the internal audit unit's administrative reporting line and make any necessary changes.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: July 2010.

While we believe that the internal audit function has had sufficient independence in its operations, as well as full access to the Board, we will formally review procedures and the reporting structure to determine where improvements can best be made. The Board did previously give input on the annual audit schedule and did receive presentations of all audit reports on at least a quarterly basis through the Finance and Administration Committee. In order for the internal audit process to be more formally added as part of the overall audit review procedures, the Board will create the expanded Finance, Administration and Audit Committee. Specific consideration will be given through the expanded Committee regarding how best to give internal audit a more formal and more direct reporting line to the Board, including having the Committee review the annual evaluation of the Manager of Internal Audit. We agree that the current administrative reporting structure is fully functional, but we will review if there are improvements that can be made to more clearly delineate the internal audit administrative reporting line.

Recommendation No. 12:

The Regional Transportation District Board of Directors should ensure that its committee structure promotes accountability, an adequate division of labor, and subject-matter expertise by:

a. Adopting for each standing committee a charter that clearly establishes the committee's jurisdiction, purpose, role and responsibilities, membership, subcommittees, operating procedures, and reporting requirements. The Board should adopt for each ad hoc committee a more limited charter that establishes the committee's jurisdiction, purpose, and role and responsibilities. Each committee should annually evaluate its performance against its charter and report to the Board with recommendations for changes to the charter.

b. Establishing a standing compensation committee and a standing audit committee of the Board. The compensation committee should be responsible for overseeing all aspects of the general manager's employment agreement, compensation package, and performance evaluation. The audit committee should be responsible for overseeing all internal and external audit-related activities of the District. The compensation committee and the audit committee should be required to provide updates to the full Board on a routine basis.

c. Reevaluating use of the committee of the whole as the primary means of organizing the Board's standing committees and committee activities.

Regional Transportation District Board of Directors Response:

a. Agree. Implementation date: November 2010.

The Board will adopt an updated description for each of the committees that identifies roles and responsibilities, incorporating key issues raised by the State Auditor. The Board will also review the activities of all of the committees annually and will review the overall Board committee structure to ensure it continues to meet the needs of the District.

b. Agree. Implementation date: July 2010.

As part of the overall general manager's compensation procedures, the Board has formally established the General Manager Oversight and Performance Management Committee that is primarily delegated with these responsibilities. The Board will also create the expanded Finance, Administration, and Audit Committee so the internal audit process can be more formally added as part of the overall audit review procedures. Both committees will provide regular updates on committee activities to the full Board as part of the regular monthly Board meeting.

c. Agree. Implementation date: Implemented.

The Board of Directors appreciates the comments of the State Auditor regarding its committee structure. While both methods (standing committees with limited members and committees of the whole) have advantages and disadvantages, the Board believes its current committee structure best serves the needs of the District and the Board. The Board previously utilized a committee structure with a limited membership assigned to specific committees, and we have found that the committee-of-the-whole structure is more effective.

Recommendation No. 13:

The Regional Transportation District Board of Directors should improve its governance and oversight practices by:

a. Developing a written governance manual describing the roles, responsibilities, policies, and procedures for key areas of Board activity and function. Once developed, the Board should review and update the manual annually.

b. Developing a succession plan for the general manager and other senior management positions to ensure the continuity of operations.

c. Leveraging available resources within the Board Office and contracting directly with consultants and subject-matter experts when necessary as additional support for Board activities.

Regional Transportation District Board of Directors Response:

Agree. Implementation date: October 2010.

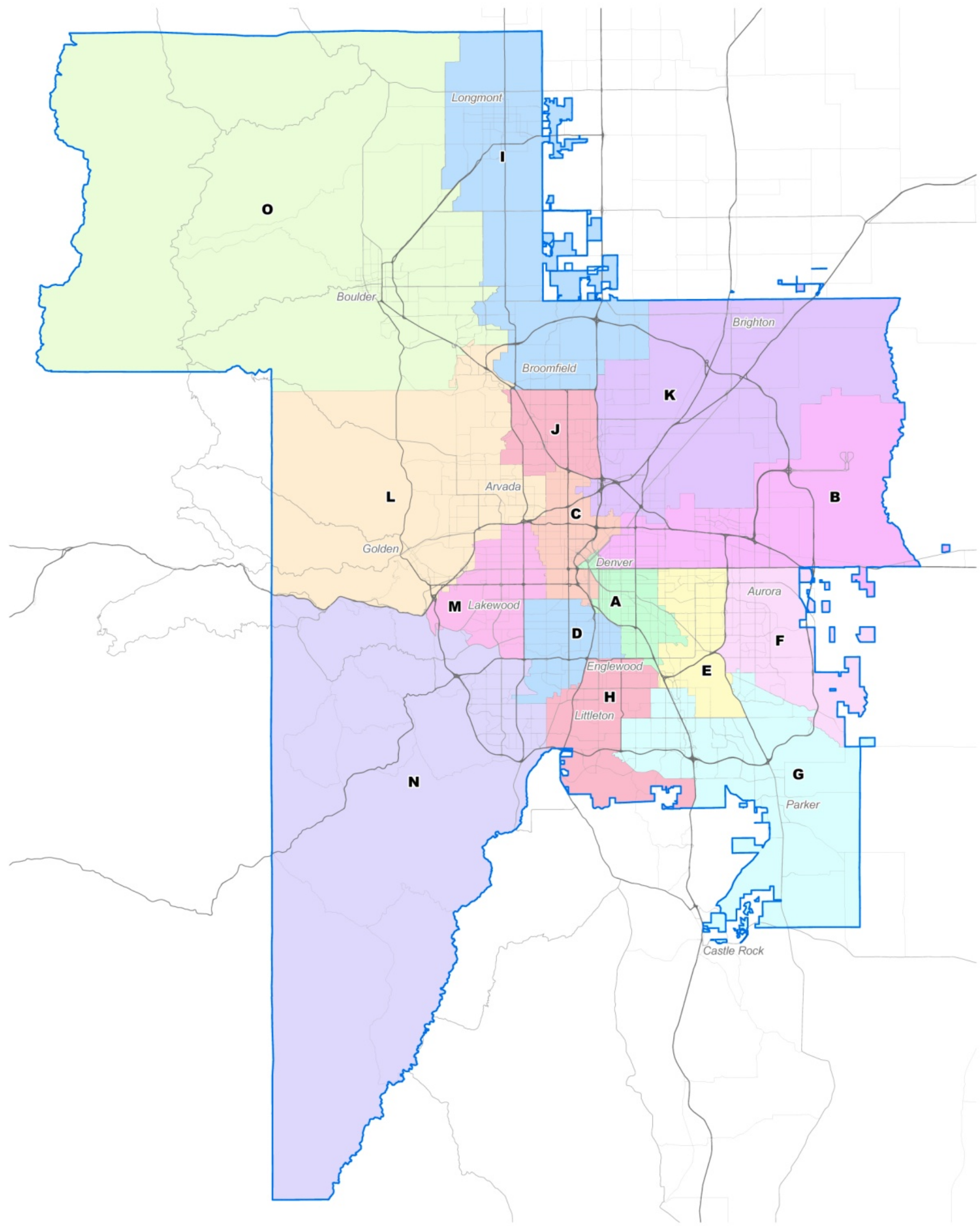
We fully agree that the methodologies previously used to calculate, evaluate, and administer the former general manager's employment agreement and compensation package could have been improved, and those improvements are reflected in the new general manager's contract. We do believe that the overall governance of the Regional Transportation District has been very effective. The District has been able to weather the recent economic downturn much better than most of its other transit partners throughout the country. To continue this active governance, we appreciate the State Auditor's suggestions regarding general governance issues.

a. The Board has had in place for many years an RTD Board resource manual that covers Board by-laws, policies and procedures. We will establish a more detailed manual addressing the roles and responsibilities associated with the overall governance of the District. As with all new procedures addressed in this audit, this manual will be continually reviewed and updated to ensure it is accurate, effective, and up to date.

b. The new general manager and the senior leadership team have each developed specific succession plans, delineating direct reports who will serve in an acting role during their temporary absence, or in a longer term scenario pending a recruitment should there be a vacancy. Each of these positions will continue to develop and improve the abilities of their direct reports. These succession plans will be reviewed annually to ensure they are current. RTD is proud of the experience and expertise of its staff and managers and is confident that this pool of dedicated individuals is able to provide high quality management and service as vacancies and opportunities become available.

c. The District will always be open to the solicitation of and use of information and expertise from outside experts and consultants when the Board believes there is an identified and legitimate need. For example, the RTD Board hired an external executive search firm and a liaison firm to provide expertise and assistance in the recently completed international search for the new general manager. In addition, RTD hired an external attorney who specializes in employment law to assist with the District's negotiations for the new general manager's contract. The Board will also explore additional ways to leverage resources available in the Board Office.

Appendix A
Regional Transportation District Map and Director Districts
(as of January 2010)



Source: Regional Transportation District.
Note: Letters represent each of the 15 director districts.

Appendix B
Key Provisions in Regional Transportation District General Manager Employment Agreements, 1995-2009

		1995-2000[1]	2000
Cash Payments	Base Salary and Means of Base Salary Increase	$148,535 Increases in base salary and any other financial incentives for outstanding or exceptional performance are based on a performance evaluation completed by the Board annually.	$170,000 Increases in base salary and any other financial incentives for outstanding or exceptional performance are based on a performance evaluation completed by the Board annually.
	Monetary Incentive Payment	Board to set performance goals *for the District* on an annual basis. Monetary incentive payment of 3 percent of current annual salary if at least 90 percent of the District's performance goals are met. Monetary incentive payment of 5 percent of current annual salary if at least 95 percent of the District's performance goals are met.	Board to set up a monetary incentive award opportunity tied to specific performance objectives and based on annual priorities. Monetary incentive payment of 10 percent of current annual salary if annual goals are achieved.
Leave	Vacation	Three weeks per year. Maximum accrual based on years of service (maximum of 336 hours with 15 or more years), in accordance with policy for other salaried employees. Unused accrued vacation time is paid out at 100 percent upon retirement/separation, in accordance with policy for other salaried employees.	23 days per year. Maximum accrual based on years of service (maximum of 336 hours with 15 or more years), in accordance with policy for other salaried employees. Unused accrued vacation time is paid out at 100 percent upon retirement/separation, in accordance with policy for other salaried employees.
	Sick Leave	Accrue eight hours of sick leave per month in accordance with policy for other salaried employees. Maximum accrual of 1,000 hours, in accordance with policy for other salaried employees. Unused accrued sick leave paid out at a percentage rate based on years of service (maximum of 50 percent with more than 20 years), in accordance with policy for other salaried employees.	Accrue eight hours of sick leave per month in accordance with policy for other salaried employees. Maximum accrual of 1,000 hours, in accordance with policy for other salaried employees. Unused accrued sick leave paid out at a percentage rate based on years of service (maximum of 50 percent with more than 20 years), in accordance with policy for other salaried employees.
Retirement	Salaried Employees' Pension Plan (Defined Benefit)	Accrue one year of service credit for each year worked, in accordance with policy for other plan participants. Fully vested after initial three-year contract term.	Accrue one year of service credit for each year worked, in accordance with policy for other plan participants. Additional five years of service credit to be awarded upon completion of a total of seven years of employment with the District.[2]
	457 Deferred Compensation Plan	General manager must make own contributions to the deferred compensation plan, in accordance with policy for other salaried employees.	General manager must make own contributions to the deferred compensation plan, in accordance with policy for other salaried employees.
	Excess Benefit Plan	Not applicable.	Not applicable.
Performance Evaluation		Board shall review and evaluate general manager performance at least annually.	Board shall review and evaluate general manager performance at least annually.

Source: Office of the State Auditor's analysis of general manager employment agreements provided by the Regional Transportation District.
[1]Represents the initial employment agreement plus three addenda to the agreement.
[2]A new employment agreement was negotiated in 2001 before the general manager's seventh year of service.

2001-2004	2005-2007	2007-2009
$205,000 Increases or decreases in base salary are determined by calculating the percentage change in the average value of total compensation packages paid to general managers in Atlanta, Cleveland, Dallas, Houston, and Washington, D.C.	$236,855 Increase in base salary is determined by calculating the percentage change in the average value of total compensation packages paid to general managers in Atlanta, Cleveland, Dallas, Houston, and Washington, D.C. No increase if the general manager's salary is at or above the average. No decreases in base salary will occur.	$269,657 Increase in base salary is determined by calculating the percentage change in the average value of total compensation packages paid to general managers in Atlanta, Cleveland, Dallas, Houston, and Washington, D.C. No increase if the general manager's salary is at or above the average. No decreases in base salary will occur.
Board to set up five performance goals agreed to by the Board and general manager by December 31 of each year. Monetary incentive payment of 2.5 percent of base salary for each goal attained. Total monetary incentive payment possible equals 12.5 percent of base salary.	Board to set up five performance goals agreed to by the Board and general manager by December 31 of each year. Monetary incentive payment of 2.5 percent of base salary for each goal attained. Total monetary incentive payment possible equals 12.5 percent of base salary.	Board to set up five performance goals agreed to by the Board and general manager by December 1 of each year. Monetary incentive payment of 2.5 percent of base salary for each goal attained. Total monetary incentive payment possible equals 12.5 percent of base salary.
25 days per year (beginning 8/1/2001). 30 days per year (beginning 8/1/2002). No maximum accrual. Unused accrued vacation time is paid out at 100 percent upon retirement/separation, in accordance with policy for other salaried employees.	30 days per year. No maximum accrual. Unused accrued vacation time is paid out at 100 percent upon retirement/separation, in accordance with policy for other salaried employees.	30 days per year. No maximum accrual. Unused accrued vacation time is paid out at 100 percent upon retirement/separation, in accordance with policy for other salaried employees.
Accrue eight hours of sick leave per month in accordance with policy for other salaried employees. No maximum accrual. Unused accrued sick leave is paid out at 100 percent upon retirement/separation.	Accrue eight hours of sick leave per month in accordance with policy for other salaried employees. No maximum accrual. Unused accrued sick leave is paid out at 100 percent upon retirement/separation.	Accrue eight hours of sick leave per month in accordance with policy for other salaried employees. No maximum accrual. Unused accrued sick leave is paid out at 100 percent upon retirement/separation.
Accrue 2½ years of service credit for each year worked retroactive to August 1, 1995 (the start of employment) and continuing for the general manager's full tenure.	Accrue 2½ years of service credit for each year worked retroactive to August 1, 1995 (the start of employment) and continuing for the general manager's full tenure.	Accrue 2½ years of service credit for each year worked retroactive to August 1, 1995 (the start of employment) and continuing for the general manager's full tenure.
District pays on behalf of the general manager into the deferred compensation plan on an annual basis the maximum tax-deferred amount permitted by law.	District pays on behalf of the general manager into the deferred compensation plan on an annual basis the maximum tax-deferred amount permitted by law.	District pays on behalf of the general manager into the deferred compensation plan on an annual basis the maximum tax-deferred amount permitted by law.
Not applicable.	District contributed to a governmental excess benefit plan and trust to fund the general manager's full retirement benefit above and beyond what could legally be paid from the Salaried Employees' Pension Plan.	District contributed to a governmental excess benefit plan and trust to fund the general manager's full retirement benefit above and beyond what could legally be paid from the Salaried Employees' Pension Plan.
No comprehensive evaluation of overall general manager performance.	No comprehensive evaluation of overall general manager performance.	No comprehensive evaluation of overall general manager performance.

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