



ITEM ID: 2023-335-0

TRANSMITTAL DATE: October 20, 2023

MEETING DATE: October 27, 2023

TO: Board of Directors

FROM: Elisabeth Lazuardi, Senior Manager, Audit
Arnold Hackett, Chief Financial Officer

SUBJECT: Performance Audit: Fuel Purchase Policy FIN 11.1 Rev. 2 and Rev. 3

Issue

The Internal Audit Department (Internal Audit) completed the Performance Audit: Fuel Purchase Policy FIN 11.1. Rev. 2 and Rev. 3

Recommendation

Receive and file.

Strategic Commitment

This report aligns with the Strategic Business Plan commitment of:

- **Modernizing Business Practices:** We will improve our operational efficiency through transparency, objective metrics and streamlined governance, reducing over-reliance on subsidy while bringing our system into a state of good repair and investing in the development of our employees. Controls related to the fuel purchase program are improved through the annual audit of the program.

Background

As required by the Fuel Purchase Policy FIN-11.1, "the Fuel Purchase Program shall be audited annually. In addition, the Board shall establish an Ad Hoc Committee at the time of the annual audit for the limited purpose of reviewing audit results and reporting to the Board of

Directors". Internal Audit engaged Crowe LLP to perform the audit.

Crowe LLP is a public accounting, consulting and technology firm which has been in operation since 1942 with offices and resources worldwide. The Crowe team is led by partners and directors that not only have performance audit and derivative experience, but also possess the institutional knowledge to help identify the relevant policy considerations for the Authority's fuel hedging program. Crowe has worked with fuel contracts, hedging contracts, and power purchase contracts for entities such as: the City of Long Beach, the Chicago Transit Authority, the Indiana Bond Bank, and the State of Texas.

Crowe combined its significant experience in conducting high quality performance audits for government agencies, in conformance with Generally Accepted Government Auditing Standards (GAGAS), and the demonstrated oil and gas expertise of Willis Graves & Associates, Inc. (WGA) to meet the needs of the Authority with respect to this performance audit. WGA's professionals have extensive industry experience with commodity pricing and in the design and completion of revenue audits in the oil and gas industry.

Discussion

The Board approved Finance Policy FIN-11.1 Fuel Management and Hedging in January 2015 to provide guidance for the Fuel Management and Hedging Program. The Authority engaged Linwood Capital, LLP (Linwood Capital) as the Fuel Hedging Advisor in 2017 to assist the Authority with the Fuel Management and Hedging Program.

The Board approved the amendment of the FIN -11.1 to improve the fuel hedge program by the development of four fuel hedge strategies and to rename the policy from "Fuel Management and Hedging Policy" to "Fuel Purchase Policy" in December 2020. Further amendments were subsequently made in May 2022 to revise one of the four fuel hedge strategies and in November 2022 to replace the role of the Fuel Hedge Oversight Consultant with SCRRA staff and to add a language related to the effectiveness analysis of the fuel hedge program.

The objective of this audit was to determine compliance to FIN-11.1 Revision 2 and Revision 3 for the audit period of January 2022 - December 2022. Based on the audit procedures performed, SCRRA management was determined to be in compliance, in all significant aspects, with the audit objective. The audit result was presented to the Ad Hoc Fuel Hedging Policy Committee on September 11, 2023. The audit report is attached to the item.

The Ad Hoc Fuel Hedge Program Committee held a meeting on Monday, September 11 to review the results of the External Audit. The following attendees participated in the meeting:

Metrolink Board of Directors Marquez and Trembley

Metrolink Staff CEO Darren Kettle; General Counsel Don Del Rio; Chief Financial Officer Arnold Hackett; Elisabeth Lazuardi, Senior Manager, Audit; Cynthia Minix, Director, CPMM; Alex Barber, Senior Manager, General Accounting; Eduardo Tovar, Manager II, Inventory Control; Anthony San Angelo, Accountant I

External Auditors from Crowe: Bert Nuehring, Sam Twyman and WGA Austin: Jon Ellis

There were in-depth discussions throughout the meeting. The External Auditors shared that 2022-23 renewable diesel was still priced based on conditional diesel pricing with reference to published indices and the contractual provisions. They added that in the future, there may be changes related to renewable diesel as a distinct commodity. This is often referred as an emerging commodity, and the industry is responding to it based on the demand for renewable diesel; by making changes in refining capacity and adapting existing capacity to produce renewable diesel. The external auditors noted that by 2024 they expect to see future contracts that are specific to renewable diesel. They anticipate that there may be additional industry price publications and indices that are specific to renewable diesel. The external auditors recommended these developments continue to be monitored, and work with a fuel advisor, focusing on any change or disconnect on conventional diesel prices, and renewable diesel prices. They stated presently renewable has a slight discount compared to conventional diesel. They anticipate this will change by 2024, renewable diesel will be traded at a premium. Depending on the effectiveness of the risk management program.

Based on the discussions and the projections regarding renewable diesel the following actions were recommended by the Ad Hoc Committee:

- A report in the Ad Hoc meetings by the end of this year/beginning of next for the committee to track the development of the market every six months. Also, this report should be presented to the Audit and Finance Committee every six months.
- Ad Hoc Committee stated given the current policy and four strategies rely on OPIS diesel numbers, but the information is not accessible. A pricing strategy based on a deviation of the OPIS diesel index, to the extent that petroleum and renewable prices are separating from a market standpoint, the strategies that are in the policy are averse to Metrolink. There is a need to analyze what is in the current policy because it must be nimble in an evolving market where there isn't a spot index price. There will be a need to look at the separation pricing as they look into the future.

Next Steps

The Fuel Purchase Policy will continue to be audited into the next fiscal year

Prepared by: Elisabeth Lazuardi, Sr. Manager, Audit
Arnold Hackett, Chief Financial Officer

Approved by: Elisabeth Lazuardi, Sr. Manager, Audit
Arnold Hackett, Chief Financial Officer

Attachment(s)

[Attachment A - CY2022 Fuel Hedge Policy Final Audit Report](#)