Port of Seattle

Internal Audit Report

Limited Operational Audit

Controls Over Debt Service

January 1, 2011, through December 31, 2012

Issue Date: June 11, 2013
Report No. 2013-07

Table of Contents

Transmittal Letter

Audit Committee
Port of Seattle
Seattle, Washington

We have completed an audit of Controls Over Debt Service.

The scope of the audit covered information relating to debt service from January 1, 2011, through December 31, 2012.

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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We extend our appreciation to the management and staff of Corporate Finance and Budget for their assistance and cooperation during the audit.

Joyce Kirangi, CPA, CGMA
Internal Audit, Director

Executive Summary

Audit Scope and Objective The purpose of the audit was to determine whether management has implemented adequate controls to ensure:

- Timely utilization of refinancing (i.e., refunding) opportunities to reduce overall borrowing costs.
- Compliance with applicable IRS, State, and Port requirements.
- Proper debt service cost allocation among divisions, funds, and accounts.

The scope of the audit covered the period January 1, 2011, through December 31, 2012.

Background The Port, under the authority of Chapter 53.40 RCW and Chapter 53.44 RCW, issues municipal bonds (short- and long-term obligations) to invest in necessary Port facilities, including long-term infrastructure projects. These investments support Port initiatives to promote economic vitality, to maintain optimum operations at the Port facilities, and to meet future demands.

The Port of Seattle, as of December 31, 2012, had a total debt balance of $3.3 billion, which consisted of Revenue and General Obligation (GO) bonds. The majority (91%) of the debt are fixed-rate debt with an original term of 25 to 30 years. The oldest outstanding debt issuance is from 1997 with an outstanding balance of $108.8 million.

To benefit from historically low interest rates in recent years, older debt issues have been refunded to reduce overall debt service costs. On average, the Port disburses annually $154 million in interest payments.

Corporate Finance in partnership with each division administers debt.

Audit Result Summary Management has implemented adequate controls to ensure timely utilization of refunding opportunities, compliance with applicable requirements, and proper debt service cost allocation among divisions, funds, and accounts.

Background

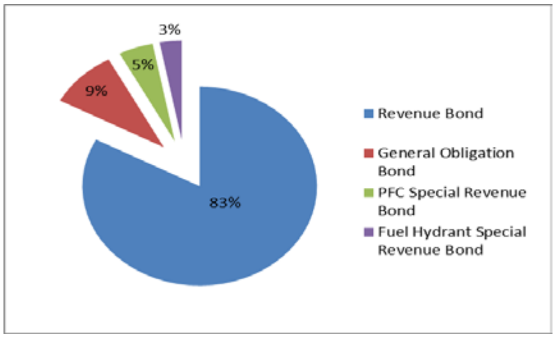
The Port of Seattle, under the authority of Chapter 53.40 RCW Revenue Bonds and Warrants, and Chapter 53.44 RCW Funding and Refunding Indebtedness - 1947 Act, issues municipal bonds (short- and long-term obligations) to invest in necessary Port facilities, including long-term infrastructure projects. These investments support Port initiatives to promote economic vitality, to maintain optimum operations at the Port facilities, and to meet future demands.

The Port of Seattle, as of December 31, 2012, had a total debt balance of $3.3 billion, which consisted of the following:

(in thousands)

Bond Types	Tax Exempt	Taxable
General Obligation	281,790	30,215
Revenue	2,329,085	404,600
PFC Revenue	157,150	0
Fuel Hydrant Special Facility	100,175	0
Total	$ 2,868,200	$ 434,815

Source: SymPro, as of 5/01/2013



The difference between the types of bond the Port issues (i.e., general obligation bonds vs. revenue bonds) depends on the security pledge for bond repayments:

- General Obligation Bonds - Port's available resources, including tax revenues, secure bond repayments.
- Revenue Bonds – Port's net revenues (e.g., airport revenues, seaport revenues) secure bond repayments.

The Port of Seattle has 91% of its debt as fixed rate and 9% as variable rate. For the past nine years, the Port has incurred the following interest payments:

Source: SymPro, as of 5/01/2013

Corporate Finance, in partnership with each division, administers debt, which involves the following processes:

- Financing projects at the lowest possible issuance costs within a required timeframe.
- Maintaining pre- and post-issuance compliance with IRS, Municipal Securities Rulemaking Board (MRSB), and bond covenants.
- Maintaining records and documentation of proper debt service cost allocation.
- Tracking bond proceeds and associated compliance requirements.
- Servicing debt (e.g., principal and interest payments).
- Refunding debt to reduce future debt service costs.

Highlights and Accomplishments

During the course of the audit, we observed that management has:

- In 2011 and 2012, the Port refunded (partially or fully) eleven separate series of outstanding Port bonds, resulting in an overall reduction in future debt service costs of approximately $151 million over the remaining life of the bonds.
- Maintained detailed policies and procedures as a guide to administer debt.
- Leveraged technology (e.g., SharePoint) to centralize debt-related information such as official debt documents, annual disclosures etc.

Audit Scope and Methodology

We reviewed information for the period January 1, 2011, through December 31, 2012. We utilized a risk-based audit approach from planning to testing. We gathered information through research, interviews, observations, analytical reviews, and obtained a complete understanding of debt administration. We assessed significant risks and identified controls to mitigate those risks. We evaluated whether the controls were functioning as intended.

We applied additional detailed audit procedures to areas with the highest likelihood of significant negative impact as follows:

1. To determine whether management has implemented adequate controls to ensure timely utilization of refunding opportunities:

    - We reviewed management processes of identifying refunding opportunities for timeliness and completeness.

        - Reviewed the Port’s debt portfolio to identify potential refunding opportunities.
        - Reviewed management’s process to identify refunding opportunities.
        - Researched refunding topics to understand the impact and likelihood of refunding.
        - Conducted a process walk-through to validate the current refunding process.
        - Verified whether management has a proper review and approval process.

- We analyzed refunding issues in 2011 and 2012 for intended savings.

2. To determine whether management has implemented adequate controls to ensure compliance with applicable rules and requirements (federal, state, bond covenants, etc):

    - We reviewed management compliance processes.

        - Conducted a process walk-through to validate the current compliance process.
        - Identified pre- and post-issuance compliance requirements.
        - Reviewed IRS requirements (which included industry best practices) against the Port's current policies and procedures to ensure completeness.

    - We determined compliance with Municipal Securities Rulemaking Board's disclosure requirements for 2010 and 2011, which includes disclosure of:

        - Financial statements.
        - Material event notices
        - Port operations, as well as financial information, to assist investors.

3. To determine whether management has implemented adequate controls to ensure debt service costs are properly allocated:

    - We reviewed the process of assigning and communicating debt service related funds and accounts.
    - We analyzed debt service costs to determine whether the costs were allocated to the correct divisions, funds, and accounts.

Conclusion

Management has implemented adequate controls to ensure timely utilization of refunding opportunities, compliance with applicable requirements, and proper debt service cost allocation among divisions, funds, and accounts.