

# Port of Seattle

## 2013 Audit Engagement Service Plan

(Provided to management and the Audit Committee on October 1, 2013)



**MOSS ADAMS** LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

999 Third Avenue, Suite 2800

Seattle, WA 98104

206. 302-6500

## SCOPE OF WORK

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The primary purpose of our audit engagements is to form an opinion on the fairness of presentation of the financial statements of the Port of Seattle for the year ended December 31, 2013 in accordance with accounting principles generally accepted in the United States of America and to audit and report on the administration of federal awards received by the Port in accordance with Federal Circular OMB A-133. The audits will be performed in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*.

The following summarizes the services to be provided:

- Audit and report on financial statements for both the Enterprise Fund and the Warehousemen's Pension Trust Fund included in the Port's Comprehensive Annual Financial Report.
- Audit and report on internal control and compliance over financial reporting in accordance with *Government Auditing Standards*.
- Audit and report on the Airport Improvement Program and other major Federal Financial Assistance Programs and related internal controls and compliance in accordance with Federal Circular OMB A-133 (Single Audit).
- Audit and report on the schedule of Passenger Facility Charge (PFC) program receipts and expenditures and related internal controls.
- Audit and report on the Schedule of Net Revenues Available for Revenue Bond Debt Service.
- Issue a management letter of recommendations and observations.

## OUR AUDIT APPROACH

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In accordance with generally accepted auditing standards and *Government Auditing Standards*, our firm utilizes a risk based approach to conduct our audits. Moss Adams performs its audit engagements using a risk-based approach that requires the auditor to obtain an in-depth knowledge of the Port's operations and the industry as a whole.

Audit risk involves the risk of material misstatement in the Port's financial statements and arises because the audit is designed to provide reasonable (not absolute) assurance that the financial statements are free of material misstatements. The audit risk model is composed of three elements; inherent risk, control risk, and detection risk, which must be evaluated and assessed separately, either quantitatively or qualitatively. We assess risk at the level of high, medium, or low.

- Inherent risk represents the susceptibility of an account balance, class of transaction, or disclosure to material misstatement based solely on their nature; this risk exists independently of the audit. For example, due to the complexity of the estimate, environmental remediation liability is an inherently risky balance. Inherent risk includes fraud risk and the risk of material misstatement due to fraud.
- Control risk represents the risk that a material misstatement could occur in a system or in an assertion that will not be prevented or detected on a timely basis by the Port's structure of internal control. Although control risk exists independently of the audit and is the responsibility of management, we will modify our audit procedures based upon assessment of the risk.
- Detection risk represents the risk that the auditor will not detect a material misstatement that exists in an assertion. It is a function of the effectiveness of applying our audit procedures.

We assess audit risk at the overall financial statement level, individual account balance, transaction, or disclosure level during the planning phase of our audit (risk assessment procedures). Our overall judgment about the level of the risks above will affect the scope of the audit, including the nature, timing, and extent of our audit procedures.

### Phase I - Planning

The following risk assessment activities are performed:

- Entrance meetings with relevant Port management and staff to discuss expectations, the audit process and timelines, and to obtain key strategic, financial, and operational information.
- Observation and inspection of documents.
- Identify Port-specific and industry developments that might require an expansion or modification of audit tests.

- Conduct risk brainstorming meeting with our own staff as well as meetings with Port Commissioners, executives, management, and other personnel.

Based on the results of the risk assessment procedures noted above, we conclude the planning phase by performing the following:

- Define the scope of the engagement including determination of potential major programs for the Federal Circular OMB A-133 audit procedures.
- Ascertain timing of conduct and completion of audit, reporting submission deadlines, and nature of reports to be issued.
- Design an efficient audit approach and audit programs with sufficient risk coverage.
- Establish preliminary materiality and the non-posting threshold for trivial matters noted during the audit

## **Materiality**

Materiality is the maximum level of misstatement that can be tolerated in the financial statements without causing a reasonable person's judgment about them to be significantly changed or influenced. We determine materiality as follows:

- Conduct preliminary analysis of financial statements to make initial judgment of materiality.
- Consider the needs and expectations of the readers of the financial statements.
- Consider both quantitative and qualitative factors.
- Major program determination is made using the guidance provided by Federal Circular OMB A-133.
- Re-evaluate materiality level throughout the engagement and conclude on final materiality level upon completion of the audit.

We identify all quantitative critical components to the financial statements such as total assets, net assets (net position), capital assets, revenue, and net income. We determine the most relevant critical component to the users of the financial statement and using a benchmark percentage, we calculate an overall materiality amount; for example a benchmark percentage multiplied by a critical component such as total revenues. We also utilize planning materiality to determine the extent of applying audit procedures; for example, it can be used in connection with performing substantive analytical procedures and in determining sample size.

## **Non-Posting Threshold for Trivial Matters**

The trivial matters threshold establishes a level for which misstatements are considered to be inconsequential to the financial statements. The trivial matters threshold is established at the planning stage and is calculated as a percentage of planning materiality. We notify Port management regarding all misstatements discovered in the audit and although we may consider a misstatement inconsequential, management may elect to record an adjustment, even if it is deemed to be trivial. All potential adjustment amounts above the trivial matters threshold are analyzed individually and in aggregate to determine potential impact to the financial statements.

## **Phase II - Assessment of Internal Control**

Internal control is a process that is designed to provide reasonable assurance over the achievement of the Port's objectives such as reliability of the Port's financial reporting, effectiveness and efficiency of operations, and compliance with the laws and regulations. The framework used in assessing the Port's internal control consists of five interrelated components; control environment, risk assessment, control activities, information and technology, and monitoring. Our firm follows a top-down approach when evaluating internal control starting with entity-level controls and narrowing to controls that relate to specific financial statement assertions as follows:

- Obtain and assess the Port's entity-level controls including the information technology environment and the effect on the internal control structure. This includes assessing the 'tone at the top'; i.e. controls in place at the Commission and executive level.
- Identify significant accounts and processes:
  - ❖ Administration of federal awards and related administrative controls
  - ❖ Billings, cash receipts, and receivables
  - ❖ Airport lease agreements, seaport and real estate leasing arrangements and other operating leases in place
  - ❖ Procurement, cash disbursements, and payables
  - ❖ Payroll
  - ❖ Capital projects
  - ❖ Treasury and investments
  - ❖ Debt and related accounts
  - ❖ Environmental remediation liability and contingencies
  - ❖ Third party management
  - ❖ Financial close and reporting
  - ❖ Information technology (general computer controls)
  - ❖ Budget

- Obtain copies of system, policy, and procedure documentation from various departments. We retain these copies in our permanent working paper files and update them annually.
- Obtain knowledge of design and implementation of controls relevant to financial statement assertions and compliance with laws and regulations that have direct and material effect on determination of financial statement amounts. After gathering this information we perform “walkthroughs” to verify that our understanding of the system and its controls is accurate and that key controls exist and are operating as designed.
- Perform tests of controls that relate to financial statement assertions and perform tests of controls and compliance related to the Port’s federal awards:
  - ❖ Allowable costs and activities
  - ❖ Cash management
  - ❖ Davis-Bacon Act
  - ❖ Equipment and real property management
  - ❖ Matching and level of effort
  - ❖ Period of availability
  - ❖ Procurement and suspension and debarment
  - ❖ Program income
  - ❖ Reporting
  - ❖ Subrecipient monitoring
  - ❖ Special tests and provisions unique to the major programs

### **Information Technology Systems and General Computer Controls**

- Determine application systems, databases, and operating systems in scope based on the business process walkthroughs of our financial audit team.
- Identify any application controls our financial audit team is planning to place reliance upon.
  - ❖ Procurement, cash disbursements
  - ❖ Payroll
  - ❖ Billing
  - ❖ Capital projects
  - ❖ Financial close and reporting

- Identify key IT general computing controls that support automated and application controls to be relied upon by our financial audit team.
  - ❖ Security and access
  - ❖ System acquisition and implementation
  - ❖ System changes/change management
  - ❖ Computer operations
- Conduct walkthroughs of significant application and general computing controls to assess effectiveness of design and implementation.
- Perform tests of IT controls and compliance.

### **Phase III - Substantive Audit Procedures**

We tailor our audit programs for each balance to obtain evidence from a combination of (1) internal control testing, (2) analytical procedures, and (3) substantive testing. The balance of evidence to be obtained from each of the three general types of procedures is determined using an audit approach decision model taking into account the strength of the Port's system of internal controls.

### **Test of Details**

- Directed testing and audit sampling are used to perform tests of certain financial statement account balances.
- Directed testing utilizes judgment and expertise and selections are based on risk and dollar value; we use directed testing approach for most financial statement balances where efficient.
- Random and judgmental sampling methods are utilized (method depends on population).
- Compliance with requirements of the major federal award programs is tested.

### **Analytical Procedures**

- In the planning phase, we perform a comparison of current and prior year results and actual and budgetary information, as well as an analysis of the Port's major transactions during the year.
- During substantive testing, we perform an analysis of the detail of changes to certain accounts such as capital asset, long-term debt, and investment accounts. For other accounts, we frequently use predictive analytical tests such as using specific data to develop expectations.

- At the conclusion of the audit, we do a holistic review of the financial statements in light of the results of other auditing procedures and assess whether we have appropriately addressed all critical areas.

### **Conferences and Audit Progress Reports**

We will schedule both an entrance and exit conference with the Port's Audit Committee and management. On a weekly basis during audit fieldwork we will provide management with a status report of progress, unusual or significant accounting issues, proposed and passed audit adjustments, potential management letter comments, and difficulties encountered, if any.

### **Phase IV - Completion of Audit and Presentation of the Audit Results**

Upon completion of substantive procedures, we assemble testing results to determine the matters that are reportable to management and to the Audit Committee. This process entails assessing whether there are control deficiencies, whether individually or in aggregate, which are severe enough to meet the definition of a significant deficiency or a material weakness. We also conduct final engagement quality control reviews and prepare required deliverables.

Finally, we are required by auditing standards to communicate, in writing, to management and those charged with governance, all significant deficiencies and material weaknesses noted as a result of our audit. For minor observations, we provide information on our observations regarding controls and various other communications either verbally or in the form of a formal management letter of recommendations to the Port.



## **AUDIT, ACCOUNTING, AND REPORTING MATTERS**

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We have highlighted certain matters of audit emphasis pertinent to the Port:

### **Bond Accounts**

The bond related accounts always provide challenging audit and accounting issues. Among them are:

- New debt issuances
- Refunding, defeasances or extinguishment
- Compliance with covenants
- Capitalized interest
- Arbitrage liability

### **Leases**

Leasing issues are complex and are prevalent in all the Port's lines of business. For instance, we will devote audit effort and resources to the following:

- Real estate transactions within the Real Estate Division
- New and significant leases at the Airport and Seaport Divisions
- Review of Port's controls over ongoing accounting and monitoring of existing leases

### **Revenue Recognition**

Revenue recognition complexities:

- Airline lease agreements
- Other operating revenue
- Tax, PFC and federal grant receipts, and investment income

### **Capital Assets**

Capital assets issues and related accounts:

- Capitalization policies and classification of closed and on-going projects
- Asset retirements and demolition
- Project costs and overhead allocation
- Depreciation expense
- Impairment analysis

### **Environmental Remediation Liability**

Environmental remediation complexities include:

- Estimation by site of future liabilities and related expense
- Asbestos remediation efforts
- Superfund site remediation efforts
- Capital vs. expense classification

### **Pension Plans and Other Post-Employment Benefits**

These include complex disclosure requirements and calculations performed by specialists which are relied upon by Port management.

## **NEW ACCOUNTING PRONOUNCEMENTS**

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GASB Statement No. 61, "*The Financial Reporting Entity: Omnibus- an amendment of GASB Statement No. 14 and No. 34*", effective for periods beginning after June 15, 2012, clarifies the guidance for including, presenting, and disclosing information about component units and equity interest transactions of a reporting entity. We will work with management to determine the impact of this statement on the Port's financial statements.

GASB Statement No. 65, "*Items Previously Reported as Assets and Liabilities*", effective for periods beginning after December 15, 2012, clarifies the appropriate reporting of deferred outflows and inflows of resources to ensure consistency in financial reporting. We will work with management to determine the impact of this statement on the Port's financial statements.

GASB Statement No. 66, "*Technical Corrections – 2011*", effective for periods beginning after December 15, 2012, resolves conflicting accounting and financial reporting guidance by amending previous GASB statements which adopt certain FASB and AICPA pronouncements. We will work with management to determine the impact of this statement on the Port's financial statements.

GASB Statements that will be effective for the Port in 2014 or later and should be evaluated are:

GASB Statement No. 67, "*Financial Reporting for Pension Plans*", effective for the Port in 2014, and improves financial reporting by state and local government pension plans by providing a decision-useful information, supporting assessments of accountability and interperiod equity and creating additional transparency. This statement replaces statement 25. We will work with management to determine the impact of this statement on the Port's financial statements.

GASB Statement No. 68, "*Accounting and Financial Reporting for Pensions*", effective for the Port in 2015, provides standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows or resource, and expense/expenditures. This standard will impact the Port's note disclosures and the accounting and reporting for the enterprise fund and the Warehousemen's Pension Trust's pension obligation. We will work with management to plan for the implementation of this standard.

GASB No. 69 "*Government Combinations and Disposals of Government Operations*", effective for the Port in 2014, and establishes accounting and financial reporting standards related to government combinations, such as mergers, acquisitions, and transfers of operations. This statement requires the use of carrying values to measure the assets and liabilities in a government merger. It also requires measurement of assets acquired and liabilities assumed to be based upon the acquisition value. This statement also provides guidance for disposals of government operations and combinations. We will work with management to determine the impact of this statement on the Port's financial statements.

GASB No. 70 *“Accounting and Financial Reporting for Nonexchange Financial Guarantees”*, effective for the Port in 2014, and improves accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. We will work with management to determine the impact of this statement on the Port’s financial statements.

- **AUDIT TIMING**

<b>AUDIT SCHEDULE</b>	<b>TIMING</b>
<b>Audit Planning</b>	
Meet with your management and accounting staff to set up the year-end audit timeline, identify and resolve pertinent issues, perform a risk assessment, and address any concerns of management or members of the audit committee or Port Commission.	October 2013
Provide management with a detailed comprehensive list of account analyses and other materials to prepare prior to the start of the audit. Work closely with those involved in the audit process to clearly identify roles and responsibilities during the audit.	October 2013
Meet with the audit committee to provide an overview of the planned scope and timing of the audit in our engagement service plan.	October 1, 2013
Meet with Port management to discuss new Port transactions or activities and new or pending accounting and auditing guidance.	Quarterly
<b>Audit Fieldwork</b>	
Perform interim field work to perform testing of the Port's internal controls and to facilitate planning for year-end audit fieldwork. Test certain accounts such as revenue recognition, leases, environmental liabilities, and construction in progress.	October 2013 and December 2013 (Testing of IT controls in December 2013)
Perform procedures related to administration of federal awards in accordance with Federal Circular OMB A-133.	October 2013 and March 2014
Perform the year-end audit fieldwork of the Port's account balances (financial statement audits and testing of Schedule of Federal Awards).	February to March 2014
Perform the audit on PFC receipts and expenditures and related internal controls.	March 2014
<b>Report Preparation</b>	
Issue our opinion on the financial statements and schedule of Net Revenues Available for Revenue Bond Debt Service.	On or before April 30, 2014
Issue Single Audit reports and PFC program audit report.	On or before June 30, 2014
Issue the draft management letter of recommendations.	On or before June 30, 2014
Meet with the Audit Committee and management to present audit results.	As requested; no later than June 30, 2014

## MOSS ADAMS AUDIT TEAM

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The management team serving on our audits of the Port of Seattle is as follows:



**Laurie J. Tish, CPA, Business Assurance Partner**

Laurie is our firm's national practice leader for Government Services. Laurie has specialized in serving governmental entities since she began her career in public accounting over 30 years ago. Laurie will serve as your lead client service partner, overseeing all projects we perform for the Port.



**Jim Lanzarotta, CPA, Business Assurance Partner**

Jim has significant experience conducting audits in accordance with *Government Auditing Standards* and Federal OMB Circular A-133. Jim will serve as the concurring review partner. The concurring review partner serves as the second partner reviewer of the financial statements and our reports and, as necessary, will consult on technical issues or key elements of the audits.



**Chris Kradjan, CPA, Moss Adams Advisory Services Partner**

Chris is a member of our Governmental Services Group and specializes as an Information Technology consultant. Chris will lead our audit procedures covering the Port's IT systems, including general computer controls.



**Kory Hoggan, CPA, Business Assurance Senior Manager**

Kory is an audit senior manager in our Governmental Services Group. Kory has over 15 years of public accounting experience and he specializes in audits of governmental entities and employee benefit plans.



**Kevin Villanueva, IT Consulting Senior Manager**

Kevin Villanueva is a Senior Manager with the Information Technology Consulting Group and leads the firm's information security and infrastructure practice. Kevin has over 16 years of experience in information technology with industry specialization in municipal enterprises. Kevin will serve as project manager for the Port's IT general controls testing procedures.

In addition, the following individuals will serve the Port of Seattle:

**Tyler Reparuk**, Business Assurance Senior: Tyler has over four years of public accounting experience and this will be his fifth year serving the Port of Seattle. Tyler will serve as a senior accountant and will spend his time assisting with supervision of staff in the field and managing each of the audits we perform for the Port.

**Lisa Dion**, Business Assurance Senior: Lisa has over two years of public accounting experience and this will be her third year serving the Port. Lisa has experience in performing governmental financial statement audits and Federal Circular OMB A-133 audits of other entities. Lisa will serve as a senior accountant and will spend her time assisting with the supervision of staff in the field and performing procedures related to the financial statement accounts and the OMB A-133 audit.

**John Witt**, Business Assurance Staff: John has one year of public accounting experience and this will be his second year serving the Port. John will primarily spend time related to the financial statement accounts, and will be working under the supervision of other members of our audit team.

**Dan Sievers**, Business Assurance Staff: Dan is new to Moss Adams and will be working under the supervision of other members of the audit team. Dan will primarily spend time related to the financial statement accounts.

**Branch Richards & Co, Subcontractor:** We have engaged Branch Richards & Co., a small business initiative firm, to serve as our subcontractor. **Gabe Rucker**, experienced staff, will be fully integrated into our audit team in working on each of the audits. This will be his second year serving the Port.

**Raymond Yamka**, IT Consulting Manager: Raymond has over twelve years of public accounting experience and this will be his second year serving the Port. Ray will serve as an IT consulting manager and will spend his time performing and assisting with supervision of the testing of the general and application IT controls.

## **COMMUNICATIONS TO AUDIT COMMITTEE**

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Auditing standards require the auditor to communicate certain matters to the Audit Committee that may assist in overseeing management's financial reporting and disclosure process.

- Auditor's responsibilities under generally accepted auditing standards
- Other documents containing audited financial statements
- Critical accounting policies and practices
- Difficulties encountered when performing the audit
- Unadjusted audit differences considered by management to be immaterial
- Significant audit adjustments
- Disagreements with management, if any
- Representations requested of management
- Judgments about the quality of accounting and sensitive estimates
- Adoption of, or a change in an accounting principle
- Method of accounting for significant unusual transactions or controversial or emerging areas
- Fraud and illegal acts
- Material weaknesses in internal control
- Major issues discussed with management prior to retention
- Ability to continue as a going concern
- Legal, regulatory, or contractual requirements not encompassed in the current engagement
- Consultation with other accountants
- Independence of Moss Adams

At the conclusion of our audits, we will present our reports, the results of our audit and the required communications noted above, to the Audit Committee.