



AMERICAN COUNCIL OF ENGINEERING COMPANIES
of Washington

**TESTIMONY OF VAN COLLINS IN RELATION TO THE PORT OF SEATTLE'S
INTERNAL AUDITS GROUP'S OPERATIONAL AUDIT ON ARCHITECTURE AND
ENGINEERING RATES**

December 9, 2019

My name is Van Collins and I am the President and CEO of the American Council of Engineering Companies of Washington. The ACEC has long had a partnering relationship with the Port. We try to work with the Port in a respectful manner and attempt to seek solutions to issues of mutual concern. We have a standing liaison committee that regularly meets for this purpose in the hope of building trust and confidence.

Unfortunately, the Operational Audit on Architectural and Engineering Consultant Rates conducted by the Port's Internal Audit Group is a very large and serious step backwards. Not because the industry has somehow been "found out", but because we believe it is inaccurate, based upon improper assumptions, and demonstrates a significant failing in the Port's processes and procedures.

Good friends must be willing to call balls and strikes sometimes with regards to each other and this is such a time. Although we tried to do this differently, we were rebuffed, so here we are. Yet, we still believe that defending the relationship between the Port and industry is worthwhile and that preventing what we see as the development of inevitable distrust with the publishing of this report is worth any short-term conflict. We believe that we have been left with no choice but to respectfully and in the strongest terms possible disagree with the conclusions and inferences being offered today even though it is our sincerest hope that our efforts are understood in constructive manner in which they are offered.

First, we have serious concerns over the methodology used. These concerns are detailed more fully in the document I have also delivered to you. In short, the IAG report is flawed because the methodology leads to an overestimation of profit, it fails to account for real

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and important costs that affect profitability, and it improperly relies upon researched information in relation to the measurement made.

Secondly, it is important to point out that the IAG did not conduct an audit in the traditional meaning of the word. The IAG did not review any firm's accounting records and is not providing evidence as to any firm's actual profit on Port projects. Instead, the IAG used a simple computer model with limited financial input to mathematically estimate the alleged profit and for which it has no ability to ascertain a statistical margin of error.

The methodology also oddly attempts to measure the ostensible profit earned by every employee of every prime and subconsultant. However, this is not what constitutes profit within the meaning of state law. What is relevant is the summation of all of a firm's employee's billed time, which is then offset by all of the allowable costs incurred. This is what determines a firm's actual profit on a project.

Even if one were to assume the IAG's computer model is valid, the report, however, still fails to provide cogent information as to whether reasonable and fair amounts have been paid to consultants. This because the methodology also overlooks the fact that it is entirely possible for a firm to charge even a 50% profit on some employees while still losing money because, when combined with amounts earned by other employees, the total firm revenues do not collectively cover the total costs incurred.

Lastly, we believe that the report demonstrates a fundamental misunderstanding of state law and the important role that profit plays in the success of Port projects.

Many people, including people well versed in public procurements, often confuse lowest cost procurement with the procurement of architectural and engineering services. Unlike the selection of construction services, the procurement of architectural and engineering services is unique and does not in any way include the selection of a lowest price bid from a group of minimally responsible bidders. Lowest price is never a consideration, ever, and it is a most qualified proposer which is important.

ACEC Washington believes this confusion occurs primarily because there is a misunderstanding as to the rationale and policies underlying state law for architectural and engineering procurements. The law reads quite simply provides number 1. . . that a

public owner must determine, as stated, a most qualified proposer and then number 2, the owner must attempt to negotiate a contract at a fair and reasonable price with that proposer. While these are steps are seemingly simple, they nonetheless contain highly nuanced policies that must also be well understood.

The Port's current processes and procedures, which were recommended by the Boston Consulting Group, do not support state policies. This is because the value of the law is not in following a mechanical step by step, turn the crack process, which tries to eliminate human judgment, and which treats the work of one employee as fungible with another. This is a lowest cost mentality at work. The central policy underlying the procurement of architectural and engineering services is that there is an intrinsic value in establishing relationships, team to team, valued individual to valued individual, and with the full use of reasoned human judgment as a necessary part of the process.

The Boston Consulting Group's processes and procedures implemented by the Port are anything but. They call for the negotiation of the fee of every employee of every prime consultant and subconsultant on each project. At the same time, the Port looks solely to its computer model as to what is allegedly a fair and reasonable rate for each employee. No other public owner does this. The Port is the outlier. The Port also ignores any contrary input from firms, even when the Port is provided with actual accounting data. The consultant's accounting documentation is deemed irrelevant and facially "unreasonable." The Port also removes from the negotiation process the involvement of any Port project staff, i.e those who actually know something about the project's needs, risks, and unique demands and with who the consultants will ultimately have to team with going forward.

The cumulative result is that the Port's procurement and negotiation of architectural and engineering services are lengthy, frustrating, focused solely on price, and often strongly adversarial. In this environment, distrust blossoms.

But, is this what state law really envisions or what leads to successful projects? The answer is a resounding, no. As stated above, state law first requires the selection of the most qualified proposer on a procurement. Not any proposer. The most qualified proposer. While the Port performs this step well, it is not clear that the Port appreciates

why this selection matters. It is because the most qualified proposer is the most likely to offer solutions to problems in the most cost effective and beneficial manner. This is where real project savings can be achieved, and it is this partnering and collegial environment that the Port should be protect. Yet, it unfortunately does not seem to recognize this since it takes more than just hiring a most qualified proposer to establish trust, collaboration and creativity.

It takes real effort and awareness that begins at the very first involvement. It is not sufficient to start once the contract is signed. It is at the very beginning of the procurement and negotiation process where a public owner has the first opportunity to either benefit its project or to hinder it. It is in the good faith process of give and take - you give a little bit, you get a little bit where state law envisions the public interest being fulfilled through the honing process of negotiating a contract at a fair and reasonable price. It is unquestionable that the focus of state law is on the project holistically rather than just the alleged profit of each employee.

Done well, the relationship flourishes and projects are benefitted. Done poorly, the relationship flounders and projects are harmed.

Lastly, even though we strongly disagree with the IAG's measurement and outcomes, the audit report before you ostensibly still relates to an examination of profit. So, why is profit so important and what is its role in the success of Port projects? The federal government offers this regulatory direction to its procurement officers:

It is in the Government's interest to offer contractors opportunities for financial rewards sufficient to stimulate efficient contract performance, attract the best capabilities of qualified large and small business concerns to Government contracts, and maintain a viable industrial base.

Negotiations aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the Government's interest. Negotiation of extremely low profits, use of historical averages, or automatic application of predetermined percentages to total estimated costs do not provide proper motivation for optimum contract performance.

It is here where the Port's processes and procedures suggested by the Boston Consulting Group have especially fallen flat. When ACEC Washington first learned of the present review, we listened to a conversation regarding profit that occurred during the Port's September Audit Committee meeting. It was from this conversation that ACEC Washington first became concerned about what was being said and the validity of the pending review. This is because we were also aware of the very large anecdotal history of concerns voiced over the past number of years by ACEC members as to how difficult the Port is to contract with and how hard it is to make a profit.

To attempt to better understand and qualify the ACEC Washington membership' views about the Port's procurement processes and procedures, a survey was sent out to each ACEC Washington member. That survey asked a series of questions about each member's level of satisfaction. The full survey report, including specific comments made by various ACEC members, is included as Exhibit "C" in the document provided to you.

To highlight a couple of responses, almost 70% of the respondents disagreed with the statement that "[t]he Port of Seattle is fair and reasonable when it comes to negotiating price" and over 72% of the respondents disagreed with the statement that "[t]he Port of Seattle understands my firm's business model and what determines its ultimate profitability on a project."

In closing, I leave you with this question. If the Port values and trusts its business partners and believes its current processes and procedures adequately meet its statutory duty to negotiate a contract at a fair and reasonable price, is it logical that there exists such a large and clear disconnect?

The truth is that the report before you is but a manifestation of a lowest cost mentality that has endemically found its way into Port procurements. The resulting myopic focus on the establishment of individual rates for each and every employee through exclusive reliance on a computer model is inefficient, out of the norm, creates adversarial interactions, and destroys any ability to focus on what is truly important. . . the big picture and what is collectively best for the project in question.

Thank you and I am happy to answer any questions.



December 9, 2019

Commissioner Peter Steinbrueck
Chair
Port of Seattle Audit Committee
Port of Seattle
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HAND DELIVERED

RE: Consulting Engineering Industry Comments and Concerns with Port's Operational Audit of Architectural and Engineering Rates

The American Council of Engineering Companies of Washington (ACEC Washington) is concerned with the audit report offered today by the Port's Internal Audit Group (IAG). We strongly disagree with its conclusions and inferences and detail our comments and concerns in the attached "Comments on IAG Operational Audit of Architectural and Engineering Consultant Rates."

ACEC Washington is a trade organization that represents more than 150 members in Washington State involved in the consulting engineering industry. Our membership encompasses firms from large to small and those that perform a majority of their services as subconsultants and as prime consultants. Our members employ over 7,500 professionals across the state.

These members also represent some of the best engineering talent in the country. In fact, firms from Washington have won the ACEC National "Grand Conceptor" award, which is for the single best engineering project of the year, a total of nine times. This is more than any other state in the country, including New York and California.

Numerous ACEC Washington members also perform services for the Port and have substantial experience with the Port's procurement and contracting procedures. They have provided services of all types and at all levels. They have been involved in types and levels, including engineering services procurements. It is unquestionable that the Port relies heavily upon these members for the success of critical Port projects.

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Lastly, ACEC and the Port have been engaged in a liaison relationship for many years with the purpose of working collaboratively on mutual issues of concern and it is in that spirit that we offer our comments and concerns.

Sincerely,

Van A. Collins
President/CEO

Cc Commissioner Ryan Calkins, Secretary
Public Member Christina Gehrke
Executive Director Stephen Metruck
Chief Operating Officer David Soike
Director Glenn Fernandes

COMMENTS ON IAG OPERATIONAL AUDIT OF ARCHITECTURE AND ENGINEERING RATES

STATE LAW BACKGROUND

Before exploring ACEC Washington's concerns with the IAG audit report, it is warranted to detail the legal foundation underpinning the procurement of architectural and engineering services in Washington.

Under Washington law, Chapter 39.80 RCW, a public owner must determine the most qualified proposer on a project and then attempt to negotiate a contract at a fair and reasonable price with that most qualified proposer.

It is ACEC Washington's experience that this law is very different than many people, including government procurement officers, often think of with regards to government procurements. The unique feature of this law is it does not include a lowest price selection from a large group of minimally "responsible" bidders (as is the case under Chapter 39.04 RCW for the procurement and selection of construction services). The rationale and policies between the two statutes could also not be any more different. These important differences are outlined in more detail in Exhibit "A" attached hereto.

In short, a person examining architectural and engineering rates must appreciate that the procurement of architectural and engineering services requires an entirely different mindset to understand both its requirements and its underlying nuances.

FAILURE TO EXAMINE CRITICAL ROLE OF FAIR AND REASONABLE PROFIT

It is self-evident that to be able to negotiate a fair and reasonable price one must also have an understanding of the numerous factors that go into a most qualified firm's revenue and costs. In short, one must understand a firm's business model to be able to evaluate the question of what constitutes fair and reasonable profit.

This is something that the Federal Government expressly provides for in statutory guidance to contracting officers under an analogous federal procurement statute. The full language of this instructive guidance is attached hereto as Exhibit "B."

Notably, this federal regulation recognizes the difference between an "idealized" initial profit and what is realized as a final "actual" profit. *"Just as actual costs may vary from estimated costs, the contractor's actual realized profit or fee may vary from negotiated profit or fee, because of such factors as efficiency of performance, incurrence of costs the Government does not recognize as allowable, and the contract type."*

This regulation further examines the critical role that is performed by a firm's actual realized profit to the governmental interest. *"It is in the Government's interest to offer*

contractors opportunities for financial rewards sufficient to stimulate efficient contract performance, attract the best capabilities of qualified large and small business concerns to Government contracts, and maintain a viable industrial base.”

Lastly, the regulation touches upon the importance of good faith negotiations to a fair and reasonable profit. *“Negotiations aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the Government’s interest.”*

The IAG’s audit review fails to take any of these important policies into account.

FAILURES OF THE IAG METHODOLOGY

IAG Has Not Conducted an Audit and Provides No Validation as to the Accuracy of its Modeled Data

The IAG conducted what has been termed an audit, but this is inaccurate given the limited review undertaken. The engineering firms involved were asked for the W-2s and pay stubs for employees utilized on the Port’s projects and for each of the firm’s audited overhead rates. The IAG already had in its possession each firm’s pay requests.

From this limited information, the IAG used a simplistic computer model to estimate what it calls “profit.” In its nomenclature, it is the profit earned by each professional from every prime and subconsultant on the reviewed projects. There is no statistical analysis nor any data provided that indicates the accuracy of the IAG’s model versus the accuracy that would be afforded through a traditional audit.

This means that the report is potentially misleading and could provide readers with a false belief that the IAG’s estimations have been validated and can be relied upon. Furthermore, it is through the use of this unvalidated data that the IAG uses to make conclusions and inferences as to whether the Port’s processes and procedures result in the award of fair and reasonable profit. This lack of validation makes this improper.

Could a more robust process have been undertaken to validate the IAG’s report? Yes, but the IAG did not take the step to conduct a traditional audit of any of the reviewed firm’s accounting records. Accordingly, there was no proper determination of whether each firm’s accounting for revenues and costs for each project was proper under Generally Accepted Accounting Principles (GAAP) and there is no comparison against which to test its model. Without this step, the IAG is incapable of truly knowing the profitability of each firm on the projects in question.

IAG Makes Improper Conclusions and Inferences Because It Only Estimates Employee Level “Profit” Rather Than Firm Level

However, even if one assumes that the IAG’s information and estimations were correct and valid, its conclusions and inferences are still improper and unsubstantiated because the IAG does not determine each firm’s “actual” profit per project. Without this information, how can the IAG make conclusions and inferences as to whether the Port’s processes and procedures result in overpayment?

This is because the IAG's model only estimated the alleged profit earned by each employee and fails to include any evaluation of the sum total number of hours billed within each profit band or any alternative evaluation of whether a fair and reasonable profit had been paid to the firm's in question.

Instead, the IAG provides only employee level profit information in the following chart¹:

Profit	10% and below	11-19%	20-29%	30-39%	40-49%	Above 50%
Number of Consultants	139	81	72	60	30	18

However, this presentation fails to demonstrate anything meaningful because it is, again, firm level profit on a project that is determinative under state law.

The importance of this distinction can be explained by using a simple hypothetical. Assume 100 hours are billed on a project at 9% individual profit (under the profit limitation that the IAG states is Port guidelines) and two hours are billed at 50% profit. The combined "idealized" profit for this firm would be 9.8% (before accounting for any non-reimbursed costs and a determination of the firm's "actual" realized profit on the project). So, even though some individual rates might be well above Port guidelines, a firm's profit on a project can still be within Port guidelines. Extending the hypothetical even more, it is even possible that, after accounting for all non-reimbursable costs, the firm's profit on this project could be reduced to near zero or even become negative.

This means that it is the combination of all billed rates and the subtraction of all proper non-reimbursed expenses (per Generally Accepted Accounting Principles) that is relevant to the discussion of fair and reasonable profit of a firm on a project. This can only be determined through a formal audit and also means that reliance upon the IAG's presented employee level profit numbers, even if assumed correctly estimated, is unjustified and can be misleading.

The IAG further fails to provide any consideration that a person might actually be worth 50% profit. Instead, the IAG holds that any individual profit rate that is over guidelines, is impermissible. However, what if there are but a handful of people with certain backgrounds, knowledge and experience who can uniquely perform a certain scope of services. Under those circumstances, the market rate for these individuals will undoubtedly rise above the Port's 10% guideline. Yet, the Port might very much need the skillsets offered by these individuals. So, is it really to the Port's benefit to arbitrarily provide limits on individual rates? We believe it is not and the determination of a person's fair and reasonable rate is determined globally by the marketplace.

¹ The chart provides one of the variables as ostensibly the "Number of Consultants." However, this is not accurate. The actual variable being presented is the total number of employees who fit within each profit band for all consulting firms and all reviewed projects.

At the same time, it should not be forgotten that firms are not free to just use employees with the highest profit levels on projects because the firm is limited by the guaranteed maximum price in the contract. A firm will instead perform the scope of work for which it contracts by using the mix of forces that it believes will be the most efficient and cost effective. Such usage will minimize the firm's financial risk that it will run up against the cap.

IAG Improperly Uses Safe Harbor Overhead Rate

The IAG states that it also utilized the WDOT Safe Harbor Overhead Rate for firms for which it did not have an overhead rate. The current WSDOT Safe Harbor Overhead Rate is 110%. Yet, per the most recent national Deltek Clarity Architectural and Engineering Industry Survey in 2018, the median overhead rate was 160% and the top quartile was 183%. Notably, this survey is readily available online for public and general use.

In addition, the IAG fails to disclose that the WSDOT "Safe Harbor Overhead Rate" is designed for use by discrete type of firm. From the WSDOT website:

WSDOT is one of the ten state [agencies] selected to participate in the "Safe Harbor" indirect cost rate (ICR) pilot program. FHWA developed the Safe Harbor Program to help remove potential financial barriers that may otherwise prevent or inhibit new, small, and disadvantaged architectural and engineering (A/E) consulting firms from entering the Federal-aid Highway Program (FAHP) funded State Administered engineering services market.

This leads to an obvious question. Were the firms to which the IAG applied the Safe Harbor Rate new, small or disadvantaged firms? If not, then the use of such an incredibly low overhead rate will artificially inflate the calculation of profit for a firm when one is examining the fully burdened rate method of payment that is utilized by the Port.

IAG Fails to Account for Loss of Profit Because of Subconsultant Utilization

The IAG also fails to account for the fact that the use of subconsultants necessarily reduces the profitability of a prime consultant or an upper tier subconsultant. This is because the hours that a firm would normally bill on a contract (and for which it would otherwise earn a profit) are no longer available to be billed by that firm. These hours are now being performed by a subconsultant.

IAG Fails to Account for Unbillable Costs

The IAG's methodology also neglects any evaluation of non-reimbursed costs that are not part of a firm's audited overhead rate. There are numerous examples of such costs that reduce firms' profitability, including but not limited to:

- Unreimbursed costs associated with the risk and administration of using subconsultants

- Losses related to unreimbursed inflation
- Unreimbursed direct costs
- Project overruns or rework
- Marketing expenses

IAG Improperly Uses Information From Other Contracting Types to Evaluate The Port's System

As discussed previously, the Port utilizes “fully burdened rates” in its procurements rather than the “cost plus fixed fee” system utilized by the WSDOT. WSDOT’s method is required by the Federal Highway Administration through application of the Federal Acquisition Rules (i.e. FARs)).

The FARs are essentially a proxy and present a uniform, detailed, and validated system for the determination and payment of fair and reasonable compensation. However, taking one piece from that unique system out of context (i.e. audited overhead rates) and applying it within the IAG’s computer model in an effort to review the Port’s system of fully burdened rates is improper.

It is an apples to oranges comparison. The approaches involved are entirely different. Firms approach any negotiation of rates differently depending on the owner involved, the contract type and the method of payment. Different strategies are necessarily employed to ensure overall profitability. Firms often also use different employees on projects using these two different payment structures.

Given this, if one uses audited overhead rates in an analysis, which is an integral and important component of the FAR system, one must also use the entirety of the FAR system. What are allowable fees, costs and, thus, profit are integrally bound together within this system and must also be considered to even be minimally accurate and fair. In for a penny, in for a pound, as it were.

IAG Improperly Uses WSDOT Allowable Profit Figure

The IAG references the amount of profit allowed by the WSDOT.

“Industry sources indicate you must consider a firm’s overhead rate before you can determine the profit markup you are paying. Consistent with this standard, most state transportation departments typically pay a 10 percent to 12 percent consultant markup on labor and overhead.” The report also references a maximum rate used by the Federal Highway Administration of 15 percent.

However, this profit is, again, at the firm level rather than the individual employee level that is analyzed by the IAG and, as has been discussed previously, the level of individual employee level profit can have little relevance to a firm’s profit. The use of this firm level information is, therefore, improper and irrelevant.

REALITY - ACEC MEMBER SURVEY

In mid-September, ACEC Washington learned of the activities of the IAG in relation to reviewing certain engineering procurements. It was at this time that ACEC Washington also listened to the audiotapes of the September meeting of the Port's Audit Committee where it was clearly intimated that the Port might well believe it is overpaying for architectural and engineering services. In fact, there was a discussion about how much the Port could potentially save on the procurement of these services.

At the same time, ACEC Washington was aware of a long anecdotal history of members commenting on how difficult the Port is to contract with and how hard it is to make a profit on Port projects.

This presented a clear and obvious disconnect and, so it was decided to conduct a survey of the ACEC membership to better characterize the membership's position on Port procurements. The results of this survey are attached hereto as Exhibit "C."

The survey confirms the existence of a large disconnect between any assertion that the Port systemically overpays engineering firms on its projects and what actually occurs in reality. For example, almost 70% of the respondents disagreed with the statement that "[t]he Port of Seattle is fair and reasonable when it comes to negotiating price." Continuing this same sentiment, over 72% of the respondents disagreed with the statement that "[t]he Port of Seattle understands my firm's business model and what determines its ultimate profitability on a project."

The large disconnect presented is patently obvious and leads inexorably to one question – how valid is the IAG's current model and how accurate is the Port's model used for the calculation of fair and reasonable rates?

CONCLUSION

It is ACEC Washington's position that the Port is not overpaying for architectural and engineering services and that the IAG report is fundamentally flawed. We further believe that, given the difficulty expressed concerning negotiating and contracting with the Port and given its poor payment history, the Port is no longer an "owner of first choice" for a large portion of the ACEC Washington membership.

We believe that the Port's posture is detrimental to its own interest and only serves to engender distrust on future projects. Regardless of the contract type or methodology used, the most important consideration for any public owner should be whether the firms with which it is contracting are making a fair and reasonable "actual" profit on each project. The amount of profit earned by and through each employee is in of itself not relevant.

In closing, ACEC Washington does not dispute the Port's interest in the present subject matter nor its ability to investigate Port projects. It is ACEC Washington's concern, however, that the Port needs to have a clear understanding of state law policies and an engineering firm's business model to effectively and fairly negotiate on its projects.

EXHIBIT "A"

IMPORTANT CONSIDERATIONS RELATED TO A/E PROCUREMENTS

- First and foremost, it must be remembered that Chapter 39.80 RCW is not in law for the benefit of architectural and engineering firms. These policies and procedures are in Washington law because it is in the public interest and for the public benefit.
- It is in the public interest and for the public benefit that the law requires public owners to select the "most qualified" firm and it is with this firm that the owner negotiates. Inherent in this process is the fact that a fair and reasonable price is not a lowest or fixed cost. The price is relative to both the project and to the most qualified firm. For example, it might be proper to pay one most qualified firm more because of its history of success, the experience and knowledge of its team, etc. Similarly, a project's risks, complexity, duration, and uniqueness all impact price.
- A contract "at a fair and reasonable price" refers to the overall amount paid on the contract, not to the amount paid to each employee.
- It is in the public interest and for the public benefit that state law recognizes the importance of a public owner negotiating with the most qualified firm a contract at a fair and reasonable price. This necessarily means that it is in the public interest and for the public benefit to undertake a give and take process where the two parties work in good faith and collaboratively towards a mutually beneficial result. It is not state law to obtain the lowest price.
- Focusing on lowest price is detrimental to the public interest and leads to distrust and adversarial relationships.
- It is in the public interest and for the public benefit that state law requires public owners to negotiate a contract, not just a fair and reasonable price. There are three basic elements to an engineering contract. These are the scope of work, the terms and conditions, and the price for the services needed to perform the scope of work. All three elements of a contract are important factors in the success of the negotiation and the project.

EXHIBIT "B"

CRUCIAL ROLE OF PROFIT TO SUCCESS OF PUBLIC OWNERS GOALS

In 48 C.F.R. §15.404-4, which is titled "Profit", contracting officers are instructed to negotiate architectural and engineering contracts with the following thoughts in mind regarding profit (note – the blue text insertions are additions made by ACEC Washington's to provide commentary and context as to the significance of the section following immediately following thereafter):

(a) General. This subsection prescribes policies for establishing the profit or fee portion of the Government prenegotiation objective in price negotiations based on cost analysis.

Recognition of Idealized vs. Actual Profit

(1) **Profit or fee prenegotiation objectives do not necessarily represent net income to contractors.** Rather, they represent that element of the potential total remuneration that contractors may receive for contract performance over and above allowable costs. This potential remuneration element and the Government's estimate of allowable costs to be incurred in contract performance together equal the Government's total prenegotiation objective. **Just as actual costs may vary from estimated costs, the contractor's actual realized profit or fee may vary from negotiated profit or fee, because of such factors as efficiency of performance, incurrence of costs the Government does not recognize as allowable, and the contract type.**

"Owner of First Choice" – Recognition of Value of Attracting Highly Qualified Firms

(2) **It is in the Government's interest to offer contractors opportunities for financial rewards sufficient to stimulate efficient contract performance, attract the best capabilities of qualified large and small business concerns to Government contracts, and maintain a viable industrial base.**

Recognition of Negative Effect on Projects if Goal is to Unduly Reduce Profit

(3) Both the Government and contractors should be concerned with profit as a motivator of efficient and effective contract performance. **Negotiations aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the Government's interest.** Negotiation of extremely low profits, use of historical averages, or automatic application of predetermined percentages to total estimated costs do not provide proper motivation for optimum contract performance.

EXHIBIT "C"

**RESULTS FROM ACEC MEMBERSHIP SURVEY REGARDING
PORT OF SEATTLE PROCUREMENTS**

Explain your firm's historical involvement with the Port of Seattle procurement of professional services	# Selected	% Selected
My Firm is Currently or Recently Working for Port & Would Like to Continue	23	44.2%
My Firm is Currently or Recently Working for Port & Does Not Desire to Continue	1	1.9%
My Firm is Currently or Recently Working for Port & Are Unsure About Continuing	13	25.0%
My Firm Used to Perform and Would Like to Pursue Future Work	1	1.9%
My Firm Used to Perform but Will Not Pursue Future Work	1	1.9%
My Firm Has Not Performed, but Would Like to Pursue Future Work	10	19.2%
My Firm Has Not Performed Work for the Port and Will Not Pursue Future Work.	3	5.8%
Totals	52	100.0%

Describe the role in which your firm has performed work for the Port of Seattle	# Selected	% Selected
Fairly Equally as Sub and Prime	11	28.2%
Primarily as a Prime	14	35.9%
Primarily as a Sub	14	35.9%
Totals	39	100.0%

The Port of Seattle is fair and reasonable when it comes to negotiating price.		# Selected	% Selected	Subtotals
Strongly agree		1	2.6%	23.1%
Substantially agree		5	12.8%	
Slightly agree		3	7.7%	
Neither agree nor disagree		3	7.7%	7.7%
Slightly disagree		6	15.4%	69.2%
Substantially disagree		14	35.9%	
Strongly disagree		7	17.9%	
Average Score	-10.00			

EXHIBIT "C"

The Port of Seattle understands my firm's business model and what determines its ultimate profitability on a project.		# Selected	% Selected	Subtotals
Strongly agree		1	2.6%	12.8%
Substantially agree		4	10.3%	
Slightly agree		0	0.0%	
Neither agree nor disagree		6	15.4%	15.4%
Slightly disagree		3	7.7%	72.3%
Substantially disagree		18	46.2%	
Strongly disagree		7	18.4%	
Average Score	-13.95			

The Port of Seattle is fair and reasonable when it comes to negotiating allocation of risk.		# Selected	% Selected	Subtotals
Strongly agree		0	0.0%	12.8%
Substantially agree		3	7.7%	
Slightly agree		2	5.1%	
Neither agree nor disagree		11	28.2%	28.2%
Slightly disagree		12	30.8%	59.0%
Substantially disagree		4	10.3%	
Strongly disagree		7	17.9%	
Average Score	-8.46			

The Port of Seattle's procurement of professional services are organized and well thought out.		# Selected	% Selected	Subtotals
Strongly agree		3	7.7%	20.5%
Substantially agree		2	5.1%	
Slightly agree		3	7.7%	
Neither agree nor disagree		9	23.1%	23.1%
Slightly disagree		10	25.6%	56.4%
Substantially disagree		9	23.1%	
Strongly disagree		3	7.7%	
Average Score	-5.38			

The Port of Seattle's procurement of professional services are efficient and time effective.		# Selected	% Selected	Subtotals
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EXHIBIT "C"

Strongly agree		2	5.1%	
Substantially agree		2	5.1%	12.8%
Slightly agree		1	2.6%	
Neither agree nor disagree		3	7.7%	7.7%
Slightly disagree		8	20.5%	
Substantially disagree		15	38.5%	79.5%
Strongly disagree		8	20.5%	
Average Score	-13.08			

The Port of Seattle's procurement of professional services are structured in a way that encourages firms to compete for Port projects.		# Selected	% Selected	Subtotals
Strongly agree		3	7.7%	
Substantially agree		2	5.1%	28.2%
Slightly agree		6	15.4%	
Neither agree nor disagree		3	7.7%	7.7%
Slightly disagree		7	17.9%	
Substantially disagree		13	33.3%	64.1%
Strongly disagree		5	12.8%	
Average Score	-7.63			

The Port of Seattle exhibits a clear desire to be a "preferred client" of my firm.		# Selected	% Selected	Subtotals
Strongly agree		3	7.7%	
Substantially agree		1	2.6%	15.4%
Slightly agree		2	5.1%	
Neither agree nor disagree		8	20.5%	20.5%
Slightly disagree		5	12.8%	
Substantially disagree		10	25.6%	64.1%
Strongly disagree		10	25.6%	
Average Score	-10.77			

The Port of Seattle's procurement of professional services are structured in a way that helps promote collaboration and creativity.		# Selected	% Selected	Subtotals
Strongly agree		2	5.1%	
Substantially agree		4	10.3%	23.1%
Slightly agree		3	7.7%	
Neither agree nor disagree		7	17.9%	17.9%

EXHIBIT "C"

Slightly disagree		13	33.3%	59.0%
Substantially disagree		7	17.9%	
Strongly disagree		3	7.7%	
Average Score	-4.87			

The Port of Seattle's procurement of professional services is on par with the procurements of these services by other public owners of a similar size and level of sophistication.		# Selected	% Selected	Subtotals
Strongly agree		2	5.1%	20.5%
Substantially agree		2	5.1%	
Slightly agree		4	10.3%	
Neither agree nor disagree		6	15.4%	15.4%
Slightly disagree		4	10.3%	64.1%
Substantially disagree		13	33.3%	
Strongly disagree		8	20.5%	
Average Score	-10.26			

The Port of Seattle's procurement staff are professional and courteous.		# Selected	% Selected	Subtotals
Strongly agree		4	10.3%	48.7%
Substantially agree		10	25.6%	
Slightly agree		5	12.8%	
Neither agree nor disagree		10	25.6%	25.6%
Slightly disagree		8	20.5%	25.6%
Substantially disagree		1	2.6%	
Strongly disagree		1	2.6%	
Average Score	6.15			

Comments from Firms that are currently or have recently performed work for the Port
It appears that Port technical staff have as much angst with procurement as consultants do.
I have found that regardless of the data relative to direct labor rates, the port predetermines which level of staff will be assigned to their projects, even before the project is defined. They demand experience but will not pay for it. They maintain a DL Rates database and work to reduce those each year by directing staff to drive down that in negotiations.

EXHIBIT "C"

As a firm with a long-time partnership/relationship with the Port, it has been a shame to lose the feeling of true partnership and appreciation over the last 10 years or so. The rate negotiation process has been completely removed from the end user of our services (project managers) who appreciate the services we provide and recognize the value one consultant might provide over another. The process is now disconnected from any feedback about the quality of our performance, and feels a lot like buying a car. If the goal was efficiency and cost savings, the Port would be much better served looking at the fair fees on projects than nitpicking rates. Many firms are more efficient and nimble than others, and the rate negotiation process doesn't recognize the value good engineering can provide. It feels like the procurement group's goal is trying to cut costs more than be fair, especially since engineering fees are a relatively small portion of the Port's overall budget. Rather than encouraging the use of young "star" performers by recognizing strong performance, it is easier to negotiate rates for older "average" performers than recognize engineers who outperform their level of experience. We still see all sorts of inconsistencies between rates for firms (we see rates for other consultants that seem much different than what we negotiated). Sometimes the same person can be submitted on two different contracts and be offered 20% different rates, so lack of consistency.

The current process has led to both the Port and the Consultant community being disappointed in each other. The Port has not explained the basis for the rates allowed in the face of information at the federal, state and local client levels to provide benchmarks for comparison.

The Port should be a good steward of the public trust. This means not unfairly distributing risks to those upon whom they depend to design and deliver projects. The Port should compensate firms appropriately for the risk taken and the value, creativity, innovation, service and quality delivered. Between the current version of the Professional Services Agreement and the compensation offered, there is no incentive to participate in the Port's procurement process.

POS is unbending in recognizing what our firm pays in salaries to compete for talent. No ability to make any profit on less experienced individuals. We get better rates for more experienced people but run into the fee cap on projects with their hours. Have more of a chance with fixed lump sum fees.

1. Many POS staff have indicated that their goal is to set billing rates at least 20% below market value.
2. POS established categories for consultant staff which do not align with our actual pay to individuals. This causes some billing rates to be as much as 40% lower than market value.
3. POS has been unwilling to adjust billing rates for individuals who are promoted, and instead, insist of keeping billing rates that were established several years prior.

The port has unrealistic rate expectations. I only work with the Port because I value the relationship with my Prime. I do not make money on Port projects because they do not accept our rates that are below industry already.

The Port likes hiring out of state firms to help limit long term memory of their doings (especially if things go wrong)

When negotiating rates for an additional service to add geotechnical services to my contract, the sub-consultant noted that they have a passion for working on projects and they were hoping to negotiate a rate where they could get appropriate staff. The procurement staff from the airport laughed and rolled their eyes. The Port ended up rejecting 80% of the staff submitted, including all of them with SeaTac experience.

The main issue is the determination of rates. The budgets seem somewhat fair, but the rates are not. The rate process is time-consuming, sometimes taking 4 or more iterations. And then the rates themselves are poor - we are below break-even on some employees and then on others we get only 5-6% profit. As soon as we give employees raises, we are losing money again (POS rate adjustments are usually after one year of work, which could be months after we provide raises). The margin is just too razor thin and too risky. There is no room for even the slightest scope creep.

EXHIBIT "C"

We look forward to working with the Port of Seattle to compete on par with other major public clients for our industry expertise as a partner in delivery of significant infrastructure.

The technical staff have been great to work with and are among our most valued clients; they are open to input as much as they are allowed and treat us as trusted business partners. The CPO staff, on the other hand, historically have been removed from any contact with the professional firms that they are looking to hire. In the past they have sought to negotiate hard on a take it or leave it basis which has led to hard feelings, and as a result the we among other firms have been inhibited from offering them the full range of staff they need. It has felt more like a marathon than a dialogue when negotiating contracts and service directives. This seems to be changing to a more professional approach to some extent recently though they have a long ways to go. For example, we've been on three successive on call contracts (in both prime and sub roles) and have only recently actually met our contracting officer face to face, and then it was clear that she did not have the support of her management. We interface with the Port and many other major agencies in a number of professional groups and task forces on issues like legislation, funding and diversity. Though the technical staff are engaged, for the most part the Port's procurement and contracting staff do not participate and hence lag their peers in their engagement with private industry and in keeping up with much less leading the development of best practices. Other peers like Sound Transit and WSDOT have active partnering efforts with industry, but to my knowledge the Port's CPO - alone among its peers - does not. This needs to change. For example, several years ago the national CEO and regional chapter board of the Construction Management Association of America wrote to CPO expressing concern about the Port's practices in the procurement of professional Construction Management services, and offered to meet and partner to discuss and incorporate best practices employed by other owners. To my knowledge the CPO never responded. The CEO of CMAA told me that he could not think of another major owner who had refused to engage. This needs to change.

1. After being awarded a Contract, it took us over 12 months to get under contract.
2. Loading our individual hourly billing rates with all overhead expenses is very difficult.
3. Cost for Security Badging should be covered by the Port. At least a minimum 4 hours.

EXHIBIT "C"

We do a variety of work with the Port both under IDIQs and individual projects. The RFQ, proposal, and interview process with the Port is very straightforward and clear. The proposal and selection process for each solicitation is a good process and usually clearly communicated. However, once selected the contracting and rate negotiation process is very convoluted, subjective, and onerous. Particularly on IDIQs with multiple subs, the time required to submit individual resumes from all team members and the time spent negotiating billing rates for each specific individual is excessive. Typically the Port counters with rates that are far below rates allowed by other public agencies in the state, particularly for senior and higher positions. They also limit multidisciplinary teams to one principal from the prime firm. The low allowable rates makes us question our willingness to submit on future procurements. We have multiple IDIQs and contracts and each Port contracting staff seems to propose/negotiates different rates for the same individual across different contracts and often won't accept a rate for a specific individual that was just negotiated on another Port of Seattle contract. Since each individual on a project has to have a negotiated rate, adding staff to cover new service directives can be time consuming to negotiate a rate for that new staff and get the rates approved. With the high turnover in the Port contracting staff, timely and consistent response has not happened. During projects, invoicing and other tasks are complicated with tracking each individual rate and invoicing requirements and coordination with subs on using specific people and invoice formats, yet project administration time for invoicing is not allowed to be chargeable. The majority of public agencies we work for allow for project administration time of invoicing a project to be charged to the project. While the contracting, rate negotiations, and invoicing have been very difficult, the Port Project Management, Operations, and Engineering staff are great to work with, responsive, communicative, and work hard to make projects successful. If the Port contracting process/staff could be as professional and consistent as the Port PM, operations, and engineering staff, the Port would be a great entity to work for with a lot of great infrastructure projects and benefit to the region. We would absolutely like to continue to work with the Port on their infrastructure planning and design needs, but the onerous process of contracting and often unreasonable counteroffer on rates, is making us question our decision to continue to pursue Port of Seattle work.

The Port does not recognize the market value of professional services. We have found that the Port relies on external statistics that do not match reality and that do not match market trends and market value. We would encourage the Port to adopt a multiplier approach that relies on direct salary plus audited overhead plus an allowable profit percentage. The would better match approaches taken by WSDOT and other state agencies.

I think a primary issue is that it feels that the Port fundamentally distrusts consulting firms and think firms charge too much, and in their drive to lower costs and try to have consistency between various firms, they don't understand that each firm has very different cost structures and it's not fair to treat each firm the same with respect to billing rates. Also the Port has leaned towards pushing more risk onto consulting firms, but still push for lower than market rates.

Comments from Firms that have not performed work for the Port

EXHIBIT "C"

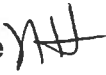
The scoring criteria is not fair. Most firms can do the work. So it ends up relationship based. As much as the Port can try and other agencies. This needs to change.

We have not worked with POS; however, or experience with other public agencies in the Puget Sound Region is that owners put undue liability on consultants in their contracting language (defense obligations), and getting fair compensation is difficult to impossible. There is too much red tape in doing professional services consulting, but we have not personally experienced this with POS (since we have not worked with them recently).

We are a minority owned engineering firm with offices in Seattle where we have 5 engineers with PEs and MSEEs. We do work for Sound Transit, SPU, King County, and WSDOT, but not the Port. Even though we have aviation experience in other cities, we find it difficult to break in with the Port.

December 9, 2019

To: Glenn Fernandez, Director, Internal Audit

From: Dave Soike, Chief Operating Officer
Nora Huey, Director, Central Procurement Office 

Re: **Management Response, Report No. 2019-11, Operational Audit,
Architectural & Engineering Consultant Rates**

In response to the Final Audit Report, please find our management response to the final report for the December 9th Audit Committee. This response incorporates the final report's recommendations as it made it easier to respond. We appreciate the recommendations and look forward to getting started on improving our rate process.

**Internal Audit Recommendations (portion copied/pasted from final report),
Finding #1:**

CPO has not established guidelines for what is determined fair and reasonable. Our testing of over 400 A&E consultants identified profit margins that exceed what the industry deemed reasonable.

Recommendations:

The Procurement Council should determine what the Port deems as a fair and reasonable rate.

Engage a third party to perform an independent model validation of the rate tool so that management can gain confidence that the model produces accurate market rates.

Management Response/ Action Plan:

CPO Management appreciates the effort of Internal Audit's team to assist in identifying areas for continuous improvements. This is consistent with the priority Port management continues to place on this as well.

In early 2019, CPO Management determined further refinements of the existing tool and process were necessary to improve efficiencies. CPO Management, with support of the Executive, sponsored an initiative to evaluate the rate negotiation process involving a

cross-functional team. We are working with the Continuous Process Improvement team and involving management and front-line staff from across the Port in the Lean project (referred to as the Rate Negotiation Lean project).

1. Our plan below incorporates the first recommendation:

The implied profit margins identified in this audit require CPO Management, in conjunction with Port Executive, to research further as part of the Port's delegated authority to obligate Port funds. Our quick test of the data shows higher overhead rates for some firms than utilized in the audit resulting in lower implied profit rates. We plan to do a robust check and have conversations with the consulting community to better understand the market and actual profitability. The Port's current contracting practice differs from cost-reimbursement type contract. The Port negotiates firm-fixed billing rates. Indirect cost rates as they relate to direct costs may differ between a cost-reimbursement type contracts and the Port's approach utilizing firm-fixed billing rates. We will conduct our due diligence within the next six months.

We will use the information gained from our research to present our recommendations to the Executive to gain buy-in on our principals related to compensation; including what the Port values and determines to be fair and reasonable and market rates. Port procedures will be updated accordingly.

2. Our plan for the second recommendation includes finalizing our Rate Negotiation Lean project to determine if validation of the model is the most appropriate step taking into consideration the collaborative efforts recommended by the cross-functional Lean team. CPO Management, with support from the Executive, is embracing and supporting our continuous process improvement culture which fosters empowering the team who actually conducts the work to recommend improvements.

DUE DATE: 6/30/2020

**Internal Audit Recommendations (portion copied/pasted from final report),
Finding #2:**

Management approval is not required when hourly rates exceed the maximum rates produced by the service rate negotiation tool / model.

Recommendations:

Implement a management review process when consultant rates exceed the maximum. This review should be documented and contain established criteria and approval thresholds (i.e. up to 20% over the maximum) for both the Services Agreement Manager and Planning and Analytics Manager to approve.

If the thresholds exceed their authority or if agreement cannot be reached, approval should be escalated to the appropriate person (i.e. director, COO) for approval, as required by the authority guidelines.

Management Response/ Action Plan:

Our practice is to allow the team (the Rate Analyst, Contract Administrator and Requesting Department Representative) the ability to exceed the maximum when all three were in agreement without escalating to management. The purpose is to empower the team and be more responsive during negotiations. Our existing process can be refined by providing additional guidance on how to properly document the decision.

In regards to the recommendation, the following steps have been taken to support this program:

1. In February 2019, CPO Management launched an enhanced Negotiation Summary Memo template incorporating guidance on how to document decisions made by the Contract Administrator with input from the Rate Analyst and Project Manager; and/ or when escalated to management for approval.
2. In July 2019, CPO Management launched a refined Service Agreements' filing system to ensure rate decision documentation is filed and saved accordingly.
3. In November 2019, CPO Management launched a Planning and Analytics' filing system to ensure rate recommendation documentation is filed and saved separately from the Service Agreements' filing system.
4. In November 2019, CPO Management launched an interim enhancement to our existing process while we conduct the continuous process improvement for rate negotiations (The Rate Negotiation Lean Project). We are testing this on three professional service procurements. The goal is to test, refine, and update our procedures accordingly by clarifying decision making ability in our procedures.

5. As part of the Rate Negotiation Lean Project, Management will re-evaluate our internal controls and escalation process. We anticipate engaging with Executive by June 30, 2020.

DUE DATE: 06/30/2020

**Internal Audit Recommendations (portion copied/pasted from final report),
Finding #3:**

A reconciliation between the final negotiated rates and the contract does not occur. As a result, we were unable to verify that all positions and rates reflected in the contract were accurate.

Recommendation:

Retain documentation to evidence the agreed upon rate and position.

That documentation should then be used to verify that the rates are accurately captured into the contract.

Management Response/ Action Plan:

It is accurate that CPO uses the rate negotiation tool (an Excel spreadsheet) to document our rate negotiation offers/acceptance with the consultants. We use the Excel spreadsheet as a tool to help us communicate offers and acceptance over multiple rounds with the prime consultants and multiple subconsultants. It is not part of the contract. The contract represents the agreement between the Port and the consultant.

We have learned through the efforts of this internal audit the Rate Analyst and the Contract Administrators frequently used other supplemental sheets and email exchanges to document/ finalize the rate negotiations.

Here are the efforts previously taken and our plan to refine our existing process in the future:

1. In February 2019, CPO Management launched a refined Negotiation Summary Memo Template incorporating additional guidance on how to document rate negotiation decisions.

2. In July 2019, CPO Management launched an enhanced Service Agreement filing system to ensure rate recommendations and decision documentation is filed and saved accordingly. This includes documenting when decisions were escalated to management.
3. In November 2019, CPO Management launched a Planning and Analytics filing system to ensure rate documentation is filed and saved separately from the Service Agreement's filing system. This is a departure from filing directly in Service Agreement's filing system.
4. In November 2019, CPO Management re-established the proper use of the rate tool of transferring accurate rate data and verification between the Rate Analyst, the Contract Administrator, the Contract Administrator and the consultant. Using supplemental sheets and email exchanges are appropriate; however, decision-making must be documented as noted in item #1, above.
5. As part of our Rate Negotiation Lean project, we will evaluate and implement additional mechanical refinements to the existing tool to simplify the documentation process with the intent to remove waste. We will update our procedures accordingly.

DUE DATE: 06/30/2020

**Internal Audit Recommendations (portion copied/pasted from final report),
Finding #4:**

The Central Procurement Office is responsible for procuring all contracts related to public works, consulting services, and goods and services. Governance with Executive Leadership Team (ELT) oversight of CPO does not occur.

Recommendation:

The Chief Operating Officer should lead an effort to determine the meeting frequency and information that is deemed necessary to perform effective governance.

We also recommend at a minimum, the CFO, Managing Directors of Aviation and

Maritime, attend these meetings.

Finally, we recommend developing a charter that defines the purpose, objective, and voting rights (if necessary) within the Governance Committee.

Management Response/ Action Plan:

Executive Leadership Team (ELT) oversight of CPO does occur. CPO Management engaged with the Executive Leadership Team on procurement matters multiple times during the 2018 and 2019 leadership retreats. Issues addressed in those meetings included: lessons learned from state audit and resulting proposed changes; Diversity in Contracting; improvement initiatives; minority and women business enterprise (MWBE) utilization reporting and dashboard, and most recently updates on 2019 process improvements. As the Port moves forward for efficiency reasons, issues related to procurement will be covered in executive retreats. When necessary, meetings with additional staff outside of the Executive Leadership Team will be set up to handle specific issues.

DUE DATE: 06/30/2020

Port of Seattle

2019 Audit Engagement Service Plan



*Provided to management and the Audit
Committee on December 9, 2019*



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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 certain members of the Audit Committee represented by the Port Commissioners, 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 transactions and industry developments that might require an expansion or modification of audit tests.
- Conduct risk brainstorming meeting with our own team as well as meetings with Port 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 Uniform Guidance and the applicable 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 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.



- Environmental remediation liability and contingencies
 - Third party management
 - Financial close and reporting
 - Information technology (general and application computer controls)
 - Budgeting process
- Obtain or update 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
 - 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, including compliance with the Davis-Bacon Act.

Information Technology (IT) 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



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

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
- Arbitrage

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
- Review of Port's controls over ongoing accounting and monitoring of existing leases
- Implementation of new GASB 87, addressing leases and effective starting in 2020

Revenue Recognition

Revenue recognition complexities:

- Airline lease agreements
- Other operating revenue (including cruise ship terminal revenue)
- Tax, PFC and federal grant receipts, and
- Investment income



at least annually. Additionally, this statement requires disclosure of information about the nature of the government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets.

GASB No. 84 "*Fiduciary Activities*." Effective for the Port in 2019, this Statement addresses the improvement of guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes, and how these activities should be reported.

GASB Statement No. 88, "*Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*". Effective for the Port in 2019, this Statement debt for purposes of disclosure in notes to financial statements as a liability, and requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses.

GASB Statements that will be effective for the Port in future years, which should be evaluated are:

GASB No. 87 "*Leases*." Effective for the Port in 2020, this Statement is intended to better meet the needs of financial statement users by improving accounting and financial reporting for leases. This standard requires the recognition of certain lease assets and liabilities for leases that were previously classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the underlying contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset and as such, a lessee is required to recognize a lease liability and an intangible asset right-to-use asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about the leasing activities. We will continue working with management to determine the impact of this statement on the Port's financial statements.

GASB No. 89 "*Accounting for Interest Cost Incurred before the End of a Construction Period*". Effective for the Port in 2020, this statement establishes accounting requirements for interest cost incurred before the end of a construction period, and requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred.



Moss Adams Audit Team

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



Olga A. Darlington, CPA, Business Assurance Partner

Olga specializes in serving governmental entities and has significant experience conducting audits in accordance with *Government Auditing Standards* and Federal Uniform Guidance, and addressing complex transactions and technical issues. Olga has over 20 years of public accounting experience and will serve as your lead client service partner, overseeing all services provided to for the Port.



Tammy Erickson, CPA, Business Assurance Partner

Tammy specializes in serving governmental entities and has over 20 years of public accounting experience and will serve as the concurring engagement reviewer, performing a secondary review of our audit plan, the financial statements and our reports and, as necessary, will consult on technical issues or key elements of the audits.



Maria Braun, IT Consulting Audit Senior Manager

Maria has experience in governance, risk management, and compliance with a strong background in technology. Maria will spend her time conducting the general and application IT control test procedures as part of our assessment of the Port's controls related to the audit.



Tyler Reparuk, CPA, Business Assurance Senior Manager

Tyler has ten years of public accounting experience and this will be his tenth year serving the Port. Tyler has experience in performing governmental financial statement audits. Tyler will manage the engagement and spend his time overseeing our staff in the field, reviewing the work performed by staff and addressing technical issues throughout the year.



Anna Waldren, CPA, Business Assurance Manager

Anna has five years of public accounting experience and this will be her fourth year serving the Port. Anna has experience in performing governmental financial statement audits and Federal Uniform Guidance audits. Anna will serve as a manager and spend her time reviewing the work performed by staff in the field, assisting with the supervision of staff in the field, and managing each of the audits of the Port.



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- Ability to continue as a going concern
- Legal, regulatory, or contractual requirements not encompassed in the current engagement
- Consultation with other accountants, if any
- 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.