

# Port of Seattle

## 2009 Audit Engagement Service Plan

Presented to the Audit Committee on December 1, 2009



# MOSS-ADAMS LLP

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## SCOPE OF WORK

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The 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, 2009 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 Charges (PFC), 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 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 brainstorming risk brainstorming meeting with our own staff as well as meetings with Port Commissioners, executives, management, and other personnel

Based on the results 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, 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 % 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 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. We use the COSO framework in assessing the Port's internal control, which 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 to controls that relate to specific financial statement assertions as follows:

- Obtain and assess the Port’s entity-level controls including information technology environment and the effect on the internal control structure
- Identify significant accounts and processes
- 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 it’s 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

### **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 a comparison of industry benchmarks to your results
- 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 Port Commission. 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 in the form of a formal management letter of recommendations to the Port.

## **AUDIT, ACCOUNTING, AND REPORTING ISSUES**

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We have highlighted certain accounting issues pertinent to the Port, along with an overview of our planned response.

### **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:

- Signatory Lease and Operating Agreement (SLOA)
- 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 work orders
- Asset retirements and demolition
- Project costs and overhead allocation
- Depreciation expense
- Impairment analysis

The Port is in the process of acquiring the eastside rail corridor from Burlington Northern. Capital Assets issues surrounding this transaction will include valuation of this parcel of land and proper recording of acquired assets. Another issue is the closing of the remaining charges comprising the 3<sup>rd</sup> runway project at Sea-Tac airport.

## **Pollution Remediation Obligations**

Pollution remediation complexities include:

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

## **NEW AND FUTURE ACCOUNTING PRONOUNCEMENTS**

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GASB Statement No. 55, “The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments”, effective for the Port in 2009, specifies the hierarchy of GAAP as applied to governmental entities. Application of this standard should have no impact on the Port’s operations or financial statements.

GASB Statement No. 56, “Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards”, effective for the Port in 2009, codifies accounting and financial reporting guidance. Application of this standard should have no impact on the Port’s operations or financial statements.

Government Accounting Standards Board Statement (GASB) No. 51, “Accounting and Financial Reporting for Intangible Assets”, effective for the Port in 2010, establishes guidance for identifying and recognizing intangible assets on the statement of net assets. The standard also provides specific guidance on internally generated intangible assets; including computer software.

GASB Statement No. 53, “Accounting and Financial Reporting for Derivative Instruments”, effective for the Port in 2010, addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by governments. The objectives, terms, and risks of hedging derivative instruments are required disclosures. The standard will require financial statement instruments or derivatives to be marked to market value on the financial statements. Also, footnote disclosures will include a summary of derivative instrument activity.



## AUDIT TIMING

AUDIT SCHEDULE	TIMING
<b>Audit Planning</b>	
Meet with your 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.	September - October 2009
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 2009
Meet with the audit committee to provide an overview of the planned scope and timing of the audit in our engagement service plan.	December 2009
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 to December 2009
Perform procedures related to administration of federal awards in accordance with Federal Circular OMB A-133	October 2009 to December 2009 and March to April 2010
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 2010
Perform the audit on PFC receipts and expenditures and related internal controls	March to April 2010
<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, 2010
Issue Single Audit reports and PFC program audit report	On or before June 30, 2010
Issue the draft management letter of recommendations.	On or before June 30, 2010
Meet with the Port Commission and management to present audit results.	As requested

## 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 an audit partner in the Governmental Services Group. Laurie has specialized in serving governmental entities since she began her career in public accounting 27 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 is an audit partner in the Governmental Services Group. He 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, Northwest Consulting Division Partner**

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



### **Nancy Young, Business Assurance Senior Manager**

Nancy is an audit senior manager specializing in serving governmental and not-for-profit entities for the past 13 years. She has conducted and supervised governmental financial statement audits and Federal Circular OMB A-133 audits of large, complex entities at the state, city and county level as well as special-purpose government clients. Nancy will serve as a manager over each of the audits for the Port. Nancy is also an adjunct professor at Portland State University where she teaches Governmental Accounting.



### **Alison Sellers, Business Assurance Manager**

Alison has eight years of public accounting experience. She specializes in serving construction and real estate clients. She has conducted and supervised financial statement audits of large multi-tiered entities that hold and develop real estate. She has also worked on not-for-profit engagements that have Federal Circular OMB A-133 audits. Alison will serve as a manager for the audit of the enterprise fund.



### **Kevin Villanueva, IT Consulting Manager**

Kevin Villanueva is a Manager with the Information Technology Consulting Group and leads the firm's information security and infrastructure practice. Kevin has over 13 years of experience in information technology with industry specialization in not-for-profit entities and healthcare. Kevin will serve as project manager for the Port's IT general controls audit.

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

**Eric Corcoro**, IT Consulting Manager: Eric is a manager with the Information Technology Consulting Group and specializes in reviewing, assessing, and supporting technology environments for government agencies, healthcare organizations, institutions of higher education, and public companies. He has over 12 years of information systems experience and is a Certified Public Accountant. Eric will assist Kevin in overseeing the IT audit procedures.

**Sun Yoon**, Business Assurance Senior: Sun has five years of public accounting experience, specializing in serving governmental and not-for-profit entities. Sun has conducted and supervised governmental financial statements audits and Federal Circular OMB A-133 audits of large complex entities. This is Sun's fourth year serving the Port. Sun will oversee the audit of the Port's federal awards.

**Timothy Lange**, Business Assurance Senior: Tim has over three years of public accounting experience serving governmental entities and will work on both the financial statement audits and the audit of the federal awards. This is Tim's fourth year serving the Port. Tim will serve as the senior on the financial statement audit.

**Elaine Parry**, Business Assurance Staff: Elaine has four years of experience in serving governmental entities and not-for-profit entities. This is Elaine's fourth year serving the Port. Elaine will serve on both the financial statement audits and the audit of the federal awards.

**Harn Yeh**, Business Assurance Staff: Harn has three years of public accounting and will work on both the Passenger Facility Charge audit and the audit of federal awards.

**Jeff Miller**, Business Assurance Staff: Jeff has over one year of public accounting experience and will be serving on both the financial statement audit and the audit of the federal awards. This is Jeff's second year serving the Port.

**Tad Jacroux**, Business Assurance Staff: Tad has one year of public accounting experience and will be serving on both the financial statement audit and the audit of the federal awards.

**Branch Richards & Co, Subcontractor:** We have engaged Branch Richards & Co., a small business and registered Minority Business Enterprise (MBE) firm, to serve as our subcontractor. **Derek Olson**, manager, and **Sefinat Araga**, staff, are fully integrated into our audit team in working on the financial statement audits and the audit of the federal awards.

## **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
- 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.