



**Annual Risk Assessment Plan
(A.R.A.P)**

And

Proposed 2010 Work Plan

By

*Port of Seattle
Internal Audit*

January 1, 2010 through December 31, 2010

Issue Date: January 12, 2010

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Internal Audit Profile

The Port of Seattle (Port) Internal Audit department was established in 2002 in the Accounting and Procurement Services Department, now known as Accounting and Financial Reporting (AFR). Effective January 2008, Internal Audit became a separate organizational unit with a dual reporting responsibility to the Audit Committee and to the Chief Executive Officer. The department was initially staffed by one person until August of 2006 when a second auditor was hired. As of December 2009, the department is staffed as follows:

Internal Audit Staff:

Joyce Kirangi, CPA, – Audit Director – Joyce is a Certified Public Accountant (CPA) with over 20 years of audit experience. She joined the Port in 2002 and has since then managed Internal Audit team. One of her primary duties past years was to expand the Internal Audit team (i.e., recruit, train, and hire current staff). She has led and managed the largest local government audits in the State of Washington, including King County, Pierce County, Spokane County, City of Seattle, and City of Tacoma. In her last position with the SAO, Joyce was the Regional Audit Manager for the Pierce County and Southern King County region. Joyce has significant experience in government services and government accounting and auditing. She specializes in local government audits. As part of her education self development, Joyce enrolled at the University of Washington in 2008 and successfully completed the Executive Development Program in summer of 2009.

Jack Hutchinson, CPA, CIA, CISA – Audit Manager – Jack is a certified Public Accountant (CPA), a Certified Internal Auditor (CIA), and A Certified Information System auditor (CISA) with 10-plus years of accounting and auditing experience. He joined the Port in August of 2006 and has conducted a variety of audits including compliance, internal control, and operational audits. Prior to joining the Port, Jack was a Finance Director for the City of Fircrest, in Pierce County. Prior to that, he was an auditor with the Washington State Auditor’s Office (SAO) where he worked for 4 years. Additionally, Jack has experience in accounting and financial reporting at a biopharmaceutical company and a Native American-owned and –operated casino.

Andrew Medina, CPA, CFE, – Senior Auditor - Andrew is a Certified Public Accountant (CPA), a Certified Fraud Examiner (CFE), and has over 15 years of audit experience. He joined the Port in December of 2007. Prior to joining the Port, Andrew was an internal auditor for the Clark County School District in Las Vegas, Nevada. He spent five years managing and conducting financial, operational, and compliance audits of the Nation’s fifth largest school district. As a Certified Fraud Examiner, Andrew was the department’s fraud specialist, responsible for conducting the majority of the District’s fraud investigations, as well as providing training to management and staff on fraud awareness and prevention. Prior to joining the Clark County School District, Andrew was a senior auditor with the State of Nevada Gaming Control Board. For 10 years Andrew helped regulate the casino industry by managing and conducting compliance, money laundering, and financial audits of Nevada’s largest casinos.

Mike Bosley, CPA – Senior Auditor – Mike is a Certified Public Accountant (CPA), and has over 15 years of accounting and audit experience. He joined the Port in September of 2008. Prior to joining the Port, he served as a senior internal auditor for Providence Health System in the Seattle area. He spent

4 years managing and conducting financial, operational, and compliance audits of Providence's hospitals and health care services. Mike also worked as a senior auditor for the Washington State Office of the Insurance Commissioner. Mike started his career auditing closely held corporations and partnerships for the Internal Revenue Service and also was the Regional Coordinator of the Volunteer Income Tax Assistance Program. Mike is a graduate of the University of Washington.

Margaret Songtantaruk – Auditor – Margaret joined the Port in October of 2006. She has over 20 years of accounting and auditing experience in private and public agencies. Since joining the Port, she has conducted a variety of audits including compliance, internal control, operational, and federal grants. Prior to joining the Port, Margaret was an auditor with the Washington State Auditor's Office (SAO) for 4 years where she conducted audits of local governments including the City of Seattle, City of Bellevue, City of Auburn, City of Renton, Washington State Convention Center, Bellevue Convention Center (Meydenbauer Center), Bellevue School District, and Valley Communications Center Authority etc. In her past experience, Margaret also served as a controller for various companies including Pacific Frontier, Inc., Evergreen Technologies, Inc., Unisea Foods, Inc., and Advanced Wireless Solutions, Inc.

Juanita Labosier, CPA, – Auditor – Juanita is a Certified Public Accountant (CPA) with over 20 years of accounting and auditing experience. She joined the Port January 2008 and prior to that was an auditor with the Washington State Office of the Insurance Commissioner where she worked for 5 years conducting financial, operational, and regulatory audits of insurance companies. She has over 15 years of experience as a financial analyst in the medical profession, including 5 years as a financial analyst with Premera Blue Cross. Juanita has also served as the president of the Washington Society of Certified Public Accountants (WSCPAs).

Bill Fovargue, CFSA – Auditor – Bill held several senior level audit positions with the State of Washington, Fortune 100 companies and professional consulting firms before joining the Port in September 2008. Prior auditing engagements included a broad spectrum of audit activities within Banking, State Government, Aerospace, Energy and Software Manufacturing industries. Bill achieved Certified Financial Services Auditor designation from the Institute of Internal Auditors (IIA) and has been a member of the Puget Sound Chapter of the IIA for 20 years. He is a graduate of the University of Washington. Bill is also a certified process improvement facilitator.

The team as a whole has well over 50-plus years of experience in many auditing disciplines to include, but are not limited to financial, internal control, accountability, compliance, and fraud audits. The team is sufficiently certified and conducts all audits based on applicable best practices of the profession.

Executive Summary

The annual risk assessment plan (A.R.A.P) is an effort by the Internal Audit team to identify Port-wide activities that could negatively impact organizational goals and objectives. It is a forward-looking document based on past performances, as well as ongoing and emerging issues, performed at all levels and virtually all activities within the Port through a risk prism.

The Port is a complex, decentralized, and ever-changing environment. Its operations encompass a wide spectrum of enterprise activities ranging from international trade to capital infrastructure improvements. A significant part of the Port's core businesses are sensitive not only to the economic forces of the region and the nation, but also to global economic climates. In addition, the Port is increasingly faced with competition from neighboring seaports and airports in attracting/retaining container, cruise and airline businesses. The economic sensitivity combined with competitive force changes risk outlooks frequently, and continuously poses significant business and operational challenges to the Port. Hence, it is critical to continuously identify and understand the various risks facing the Port.

We have identified the Port as having the following ten risks in its operations. These represent potential areas that may impact the Port negatively from a strategic, operations, compliance, information, and or finance risks.

- Central Processing Systems
- Revenue (lease and concession)
- 3rd Party Management
- Financial Reporting
- Special Investigations
- Organizational Internal Controls, Compliance & Accountability
- Federal Assistance
- Performance
- Enterprise Risk Management (ERM)
- Capital Improvement Program

Internal Audit does not review all areas of risk. Specifically, Internal Audit does not review operations for purposes of rendering opinions on the fair and reasonable presentation of the Port's annual financial reporting (Comprehensive Annual Financial Report) or compliance on federal assistance (Single Audit). There are external reviewers such as an independent CPA firm and inspectors from various Federal Agencies who provide such assurance of fair presentation and compliance related to the two areas. Internal Audit stays in touch with the other auditors to ensure that significant risks facing the Port are addressed.

To fully and timely consider risk, Internal Audit has implemented Port-wide risk assessment. While the assessment is an annual process of risk examination, it is continuously updated and adjusted as necessary throughout the year. The assessment is built on a balanced review of quantitative and qualitative aspects of each risk. High risk does not necessarily mean that there have been negative results. Rather, there is a possibility of negative results.

Internal Audit in the past twelve months has conducted numerous audits throughout the Port which are identified in a subsequent section of this document (Attachment A). The audits identified a number of opportunities to improve existing management controls, and the audit reports have recommended corrective actions that management could employ to realize the improvement.

Internal Audit risk assessment has identified potential areas for 2010 audits in Attachment A. Starting in 2009 reviews, Internal Audit implemented the integration of performance and Enterprise Risk

Management (ERM) elements into individual audits where possible. It was an acknowledgment of the Committee's strategic direction to focus audit resources more on the questions of effectiveness/efficiency in a risk context. Internal Audit will continue the effort in 2010 and beyond. Our audit focus will be on operational effectiveness – i.e. how effective Port management has been in achieving its objectives.

We extend our appreciation to the Audit Committee and Port Executive for their support of Internal Audit.

A handwritten signature in black ink, appearing to read "Kirangi".

Joyce Kirangi, CPA
Director, Internal Audit

Risk Analysis Approach and Methodology

Risk analysis includes: (1) risk assessment and (2) risk management. Risk assessment is a method of identifying and measuring risks, and risk management is taking appropriate action to minimize perceived significant risk. The key to risk assessment is the identification of threats and opportunities facing the Port. Risk is the potential for negative results – i.e., less than expected results. The results of negative risks are not desired and therefore the objective of risk management should be to mitigate those risks.

The following is Internal Audit's attempt to identify risks facing the Port. We will thereafter measure the risks and establish a plan on how to examine the effectiveness and efficiency of management efforts to mitigate those risks.

The Internal Audit team conducts a risk analysis annually and updates the assessment throughout the year, as necessary, based on a two-prong approach. The first approach to Internal Audit's risk assessment is intense data analysis (i.e., data mining) which is largely **quantitative** in nature. Internal Audit has been granted access to various systems including the Port's major financial system-- PeopleSoft. Using data from various financial systems, Internal Audit is able to navigate the Port's data landscape and summarize the data into cohesive auditable units. Individual units are systematically analyzed to identify risks.

The second approach to the Internal Audit risk assessment is known as **qualitative** risk assessment. The Audit uses many other factors to assess risks including, prior audit experience, professional judgments, emerging/developing issues, operational environment changes, etc. Prior audit issues are reviewed in conjunction with management responses to gauge post-audit risk. Known and potential business environment changes are considered, as well as inherent risk factors such as operation complexity, decentralized environment, new operations, eliminated activity, staff turnover, and public expectations. Internal Audit prefers to think of risk in qualitative terms rather than quantitative terms.

In the final analysis, assessment results are combined and analyzed as a whole. Cost-benefit, risk level, and economics of available audit resources are fully considered to establish audit priorities and plans for the upcoming year. Risks of likely occurrence and of the most negative impact to the Port are on the top of the priority list and will be addressed in the work plan.

In addition to the list of audits to be performed based on the overall risk analysis, Internal Audit conducts at least one central financial system audit annually. System in this context means any process (both functional and administrative) common to all units across the organization. Examples of such systems include payroll, accounts payables, billings and receivables, purchasing and procurement etc. System audits are designed: 1) to identify material system weaknesses that could compromise the system and, if not corrected, could develop into a significant *operation/reputation/compliance* risk to the Port, and 2) to assess effectiveness of management monitoring controls over common processes.

Internal Audit's 2010 risk assessment is based on the following ten (10) risk exposure elements. This is a logical grouping mechanism for all significant risks the Port faces. The grouping is cross functional in nature and entity wide. While the mechanism offers an insight into Port's overall risks, it does not readily lend itself to the audit process. To be able to audit Port operations for these risk elements, the

elements are analyzed in-depth and translated into auditable units to which audit procedures can be applied.

It should be noted that the risk elements are reviewed throughout the year to reflect environment changes. If the changes are considered significant, the work plan could be modified to reflect the changes.

Risks at the Port

The risks below are not numbered in any particular order of importance.

1. Central Processing Systems

- i. Processing systems common to all units across the Port.
- ii. Auditable Units – accounts payables, payroll, procurement, billing and receivables etc.
- iii. Risks:

- Operations – process execution risks that would prevent the system from achieving its goals and objectives, including information access risk and business continuity risk. Failure could lead to bad publicity and or reputation risks.
- Noncompliance with applicable federal, state, and local rules and regulations (payroll tax, retail tax, deposit requirements, etc.). Noncompliance could result in financial losses (e.g., fines and penalties to enforcement agencies).
- Inadequate controls to ensure 1) minimum accountability controls and 2) consistent and accurate processing.

2. Organizational Unit (e.g., departments) Internal Controls & Accountability

- i. Controls and accountability units do not necessarily equate to departments.
- ii. Auditable Units – recreation boating, commercial fishing, parking operation, (includes multiple departments), aviation maintenance, etc.
- iii. Risks:
 - Noncompliance with applicable state and local (including the Port) rules and regulations.
 - Lack of controls, transparency, and accountability regarding safeguarding of public assets (physical and intellectual).
 - Departments not effective in accomplishing their goals and missions.
 - Operation risks – execution risks that would prevent a department from reaching its objectives.

3. Revenue (lease and concession)

- i. Lease and concession agreements in exchange for the use of Port property.
- ii. Auditable Units – individual agreements (outdoor advertising, in-flight kitchen, rental cars, etc.).
- iii. Risks:
 - Unrealized revenue due to below market rent and/or concession and underreporting of concessional gross receipts.
 - Loss of cash flow due to late payments and associated penalties.
 - Absence of the audit clause to adequately protect Port interest.

4. Federal Assistance
 - i. Federal grants to finance operation and construction.
 - ii. Auditable Units – individual grants (TSA, FAA, etc.).
 - iii. Risks:
 - Loss of funding.
 - Financial loss, if repayment is ordered due to questioned costs.

 5. 3rd Party Management
 - i. Service contracts to manage Port property or operations as an extension of the Port.
 - ii. Auditable Units – individual service contracts.
 - iii. Risks:
 - Noncompliance with applicable state rules, regulations, and Port agreements
 - Funding of for-profit activity with public funds.
 - Operational effectiveness and efficiency.

 6. Performance
 - i. Efficient and effective use of Port resources as input in the achievement of objectives as output and outcome (measured against widely accepted applicable bench marks).
 - ii. Assessment of program effectiveness; economy and efficiency; internal control and compliance.
 - iii. Auditable Units – department or Port-wide performance questions regarding economy, output and outcome (e.g., does the Port contribute to the economic vitality in the region?).
 - iv. Risks:
 - Inefficient use of resources.
 - Insufficient output.
 - Programs and or objectives not effective - outcome not achieved or objectives not realistic.

 7. Financial Reporting/General Ledger
 - i. Accurate and timely financial reporting of operations.
 - ii. Auditable Units – Comprehensive Annual Financial Report (CAFR) and individual ledger accounts.
 - iii. Risks:
 - Material errors in the statements.
 - Misinformed decisions based on inaccurate financial information.

 8. Enterprise Risk Management (ERM)
 - i. Consistent and concerted efforts to identify and address risk entity wide.
 - ii. Auditable Units – ERM process as a whole.
 - iii. Risks:
 - Not having an ERM system to strategically address risks can lead to:
 - a. Unmitigated Risks
 - b. Reactive, as opposed to proactive, approach to risk
 - c. Loss of opportunities

 9. Special Investigations
 - i. Investigations resulting from the Fraud hotline and reporting of known and suspected loss of public funds to the State Auditor's Office (SAO).
 - ii. Auditable Units – individual investigations.
-

iii. Risks:

- Not timely investigated (loss of an opportunity to establish accountability).
- Continuation of inappropriate behavior.
- Publicity and/or negative perception
- Loss of public funds.

10. Capital Improvement Program

i. Construction.

ii. Auditable Units – individual CIPs and/or projects.

iii. Risks:

- Mismanagement of construction including inappropriate and noncompliance procurement practices.
- Mis/abuse of resources
- Incorrect capitalization

Subsequent to the identification of auditable units as listed above, units are assessed individually based on the following four (4) distinct yet interrelated risk elements to gauge the likelihood and extent of potential negative impact. A work plan for the upcoming year is an end product of the risk element assessment.

Risk Assessment Elements

1. Inherent Elements

- Nature of the operation, transaction flow, or systems
 1. Naturally sophisticated/complex?
 2. Labor intensive?
 3. Heavily regulated internally or by external parties?
 4. Sensitivity to economic forces?
 5. Labor driven by labor union agreements?
 6. Likelihood of federal financing?
- Information Systems
 1. Over-the-counter systems or internally developed?
 2. Systems maintenance complexity
 3. Number of systems in use?
 4. Critical to the operation (i.e., degree of dependency)?
 5. Outdated?
 6. Exception Reports?
 7. Reporting Module vs. Canned Reports

2. Internal Control Elements

- Controls
 1. Tone at the top?
 2. Significant changes in management?
 3. Recently re-organized and or re-aligned operations?

4. Written and documented policy/procedure?
 5. Communication (e.g., staff/management meetings)?
 6. Monitoring (e.g., reports, meetings, reviews, etc)?
- Prior audits
 1. By whom?
 2. The scope?
 3. Number of audit issues?
 4. Quality of management response?
 5. Follow-up (i.e., Corrective Action Plan) implemented?
 - Risk assessment?
 1. Risk appetite establishment?
 2. Control Self-Assessment performed?
3. Performance Elements
- Performance Efforts – assessment of program effectiveness, economy and efficiency, compliance, internal control etc.
 1. Performance measures implemented?
 2. Periodic/Regular Benchmarking?
 3. Performance reporting?
 - Service Output
 1. Compiled?
 2. Measured against benchmarks?
 3. Reported?
4. Compliance Elements
- Includes both: 1) ones to which the Port is subject (i.e., federal, state and local) and 2) ones to which the Port is subjecting the 3rd party.
- Revenue/Funding
 1. Revenue/Funding at risk, if found to be in noncompliance?
 2. At-risk amount material?
 - Contractual obligations (lease, concession, services, construction, etc...)
 1. Port interest adequately protected?
 2. Overly favorable to the third party?
 3. Timely reviewed and amended, if necessary?

Prior Audit Highlights

In 2009, Internal Audit conducted a number of operational and compliance audits involving all divisions of the Port.

Attachment A shows a list of audits conducted in 2009 and in prior years. Detail information on individual audits is available in the audit report. Not included in the attachment are narrowly scoped (i.e., agreed-upon procedures) engagements to review a particular transaction flow or a specific agreement. The result of such reviews has been communicated as memorandum addressed to the requester of the review.

Control Environment

The following describes the Port as a whole from a risk standpoint. Aspects of Port operations are grouped into relevant risk categories, in general terms, to facilitate an understanding of the risk the Port faces as an organization.

The Port is a complex and ever-changing environment. Its operations encompass a wide spectrum of enterprise activity ranging from international trade to capital infrastructure improvements. A significant part of the Port's core businesses are sensitive not only to the economic forces of the region and the nation, but also to global economic climates. Moreover the Port is faced with ever-increasing competition from neighboring seaports and airports in attracting/retaining businesses. The economic sensitivity and competitive force change risk outlooks frequently, and pose business and operational challenges to the Port.

Equally important to the Port in consideration of risk is the Port's organization status. As a public agency of the State of Washington, the Port is subject to a number of state statutes, regulating many aspects of its daily activity - from public meetings of the Commission to the annual budgetary requirements on the tax levy. Government regulations are an inherent risk of any public agency.

Port-wide Control Environment

- The Port is a decentralized organization. Divisions and their respective units are provided with varying degrees of authority and responsibility to conduct and manage daily activity. There are many layers of delegation of authority from the Commission, to the CEO, to the senior leadership/management, and to staff. Prior to 2009, the delegation of authority at the Port had become over-complicated and cumbersome to such an extent that mapping a particular line of authority was no longer a simple task--this issue was recognized by the Commission and management. In order to improve accountability and transparency a revised set of delegations in administrative authority was written and passed by the Commission in Resolution 3605, as amended, and in EX-2 Policy which contains delegation of authority from the CEO to the staff. The resolution represents an effort to streamline and facilitate ways in which an authority is granted. However, the resolution could not entirely simplify the complexity that is inherent in Port operations. Hence, the risk of unauthorized behavior persists, but to a much lesser degree.

- Following the 2007 SAO Performance audit, the Port centralized a number of functions to better enable management to streamline operations, especially in procurement areas. Capital Development Division (CDD) was created as a result and is now responsible for standardizing not only procurement policies and procedures but also monitoring the application of those policies and procedures in a concerted manner. However, due to the decentralized nature of the Port, the risk of control gaps and/or inconsistent application still persists.
- Based on the Port's operating model, the Port does not actively and directly engage in revenue generating activity. Rather, the Port act like a landlord, and earns its revenue through contractual relationships where external parties are granted the privilege to conduct business on Port's property and remit a fee to the Port in exchange. A significant number of these contractual relationships are in the form of lease agreements with concession provisions. The majority of the tenants/customers self report to the Port based on agreed-upon lease and concession fees. Self-reporting, as a reporting process, is high risk to the Port because it has no built-in mechanism to protect Port interest. Self reporting by Port tenants/customers is inherently susceptible to underreporting of concession fees and may lead to a revenue loss to the Port. Indeed, previous internal audits have disclosed problems of underreporting on concessionable revenue with some Port tenants. Thus, it is necessary to establish monitoring activities including periodic audits to properly mitigate this inherent risk. In spite of continuing efforts by Internal Audit to provide coverage in this area, the majority of Port tenants/customers remain unaudited. Internal Audit must maintain a degree of presence in this area as both a preventive and detective measure. At a minimum, Internal Audit presence will discourage potential wrongdoing by the lessee.
- The ongoing global economic downturn affected the Port in 2009 and will undoubtedly continue to impact operations in 2010. The Port implemented a 2-week furlough program for all non-represented employees as part of the overall cost reduction. Also included in the reduction were a significant cut in travel and Port-wide hiring freeze. Moreover, in anticipation of continuing struggle in the near term, the Port implemented the Voluntary Separation Program (VSP) as a way to reduce workforce. The program offered eligible employees an incentive for early departure and approximately 53 employees took the offer. These employees will leave the Port by the end of year.
- For 2010 budget, cost-conscious management instituted a modified zero-based budgeting approach where each budgeting unit was asked to justify every financial resource being sought. The process was thorough, comprehensive, and resulted in elimination of 100+ positions.

Information/Communication/Control Activities

- Communication at the Port takes many forms. There are policies/procedures at the Port-wide and at the individual organizational unit level as a means to communicate public, Commission, and senior management expectations.
- Port-wide policies/procedures are readily available and easily accessible via intranet, but not all procedures at the department level enjoy such easy access. In an effort to address the difficulty, the Port in 2009 implemented a SharePoint-based intranet where departments have full access

to their information without intermediaries. In doing so, departments now enjoy easy distribution and sharing of up-to-date information on policies & procedures, emerging issues, etc. Easily accessible, current, and relevant information helps management mitigate the risk of ineffective operations and noncompliance due to miscommunication. Employees are encouraged to read and share information related to their job functions. As an added benefit, such dissemination of relevant information would likely promote better alignment with management expectations as reflected in policies and procedures (i.e., compliance).

- Technology plays an import role in modern organizations. The Port is no exception. Technology is involved in all aspects of operations from parking receipts at the airport to physical access controls at Pier 69. Various technologies are being utilized to automate and streamline recurring activities to maximize efficiency gains while minimizing errors. One organizational unit (i.e., Information and Communication Technology) is mostly responsible for technology acquisitions and maintenance. The Port has a collection of software and hardware in the form of sub and stand-alone systems working as a group to provide necessary IT support. The systems communicate through management-defined inter- and intra-system rules to maintain information consistency. The system communication is particularly significant in financial and project management areas. PeopleSoft as the Port's primary system for in/external financial reporting relies heavily on its subsystems (e.g., accounts payables and receivables) to feed necessary information. It highlights the importance of frequent and regular reconciliations between systems. Without such, the information integrity cannot be maintained and reliability could become questionable. Indeed, the 2007 SAO performance audit noted that the technology used in project management groups was not consistent with the financial system.

Compliance Environment

Compliance at the Port is multi-dimensional. The following are various groups of compliance requirements to which the Port is subject.

- The Port is subject to federal regulations, many of which are federal grant and air/seaport security related. Current, Port federal audits is conducted annually by Moss Adams, an independent CPA firm. The most significant risk associated with federal audits is loss of federal funding. The loss could occur if significant material non-compliance issues are disclosed. For purposes of federal compliance, Internal Audit has relied on the work of the independent auditor and thus has not reviewed federal financial controls or compliance issues at the reporting level.
- As a public agency of the State of Washington, the port is subject to all provisions of Title 53 and related provisions of Revised Code of Washington (RCW). The State Auditor's Office (SAO) conducts accountability audits annually to ensure public interest. Additionally, other state agencies such as Dept. of Revenue and Dept. of Retirement regularly review Port operations for their respective purposes.
- Significant audit findings from SAO could reflect the Port negatively in the eyes of the public. In addition, other federal, state or local audits e.g.,- DOR, Department of Retirement, Labor Unions, and/or IRS audit findings could have a negative financial impact on the Port if the Port was found to owe money to those agencies.

- The Port is subject to numerous additional local (i.e., King County, City of Seattle, City of SeaTac etc.) and agreement-driven (i.e., bond covenants, union labor agreements) compliance requirements.
- The Port has a number of its own compliance requirements. Applicable regulations from aforementioned federal, state, and local agencies are frequently embedded as part of the Port requirements. The design is to provide reasonable assurance of compliance with applicable federal, state, and local rules and regulations through compliance with its own policies and procedures.

Enterprise Risk Assessments

The Port currently does not have a *formal policy* requirement for departments to conduct risk assessment in a systemic fashion (e.g., Control Self Assessment). However, risk assessment practices do exist throughout the Port in various silo forms. They tend to be informal, and the assessment is typically part of existing management control structures.

Some Emerging Challenges/Issues

- In 2009, staff continues to acclimate to the new environment created by CEO initiatives and external audits (i.e., SAO performance audits). New decision trees have become part of Port daily operations. While fine-tuning continues, the changes have matured enough to perform an in-process review. Such a review will examine changes thus far implemented to ensure that benefits are realizing as intended at expected speed.
- The Port implemented a new version of PeopleSoft Human Capital Management (HCM) in 2009. The version is more user-friendly and offers many more functionalities. The biggest change was the recruitment which became, for all intents and purposes, an online process. The online recruitment, as with any online process, has a number of risks including privacy and inadvertent unfairness.
- In the 2007 SAO performance audit, SAO recommended a robust project management system for the Port with a better interface to the Port's financial system. Port management issued an RFP looking for a robust one project management system. A vendor has been selected and management is working with the vendor to start the implementation process
- Under Initiative 900 (I-900), State Auditor's Office (SAO) has conducted two performance audits at the Port: 1) contracting practices in 2007 and 2) certain Seaport operations in 2009. The initiative provides a means for SAO to conduct follow-up reviews, and there have been some discussions of SAO coming back for a follow-up on the first performance audit in 2011. Such a review is likely to focus on Corrective Action Plan (CAP) in response to SAO findings.
- The Port implemented the Voluntary Separation Program (VSP) where eligible employees can leave the Port with an incentive. Among many who participated in the program were longtime employees at key management positions in various departments. The vacancy left by the program is an opportunity in the long run but a risk in the short term. Incoming management can examine existing business processes with a fresh set of eyes and ideas which could strengthen

policies/procedures. In the short term, however, risk of program/operation interruption in spite of a transition period is real. Only so much of decades of experience/knowledge can transfer in a relatively short period of time. Thus, short term inefficiency/ineffectiveness is a risk to operations. Control inadequacy and gaps in various management structures could follow as a result. At the time of this write-up, most of the key positions have been filled.

- A staff reduction of 100+ positions will unquestionably affect a number of operations from customer services at the airport to equipment/infrastructure maintenance. Unfortunately, the demand for services will not decrease proportionately with the staff reduction. In essence, more is asked of staff with less. As such, there could be varying degrees of pressure to simply get the job done which might materialize in instances of “cutting corners” in the name of efficiency. Thus, risk of control gaps and/or circumvention will likely increase. Further, the get-it-done attitude could potentially create negative internal and external customer satisfaction which will cut into the effectiveness of the programs/operations.
- The pressure of the economic downturn is equally affecting revenue streams. A number of lessees have already come before the Commission and asked for relief on their financial obligations. The lessee is undoubtedly under tremendous pressure to increase/maintain the bottom line. With mounting economic pressure, the risk of noncompliance with respect to complete and timely concession fees will likely increase. Given the majority of Port’s operating revenue originates from self-reported fees, this could pose a risk to Port’s operating revenue. Such pressure for noncompliance could be mitigated through heightened vigilance by management.
- Management shared with the Audit Committee its intention of conducting an ERM pilot project in 2010. Neither the subject unit nor the extent of the review has been determined yet, but management has made a commitment to examine potential benefits of ERM through the pilot project. Internal Audit will be an active participant in the project while maintaining its independence. A status update of the ERM pilot project is likely by July 2010.

Risk Assessment and Identification **(Quantitative and Qualitative)**

Below are ten (10) risk exposures Internal Audit considers critical to the achievement of the Port mission. Risk exposures are reviewed in full consideration of the Port's organizational status as a public entity. The department has attempted to reflect all relevant and significant risks to the Port and group the elements in a consistent and logical way.

The presence of risk simply indicates that the process of achieving the Port mission isn't without pitfalls. The identification and the subsequent measurement of risk is accomplished by measuring a number of factors related to risk such as: complexity, regulatory, technology, amount of dollars at risk, liquidity of assets, management competence, strength of internal controls, monitoring activities, frequency of internal audits etc. Internal Audit is sufficiently proficient in all areas but is especially experienced in Washington State local government operations and requirements. We will use the experience and exercise professional judgment to measure and prioritize the risks to the Port.

1. Central Processing Systems

The system refers to a group of processes common to all organizational units across the Port. A good example of a system in this context would be payroll. While each department may utilize different methodologies to accumulate/approve timesheets, all payroll entries are centrally processed by Accounting and Financial Reporting (AFR) before generating paychecks and posting transactions to the ledger. Certain controls are expected at the systems level to provide minimum assurance over accountability. Systems can play an important role in the overall control environment as all related transactions are expected to be processed by the system at some point before completion. As such, preventive and detective controls at the systems' level could be most effective and have the most impact if adequately designed and consistently applied.

Internal Audit reviewed disbursement in 2009 at Pier 69 as a central system for the Port to provide management with reasonable assurance that current practices are well controlled to ensure compliance and accountability over disbursing of funds. Disbursement in this context includes accounts payables and payroll.

In 2010, Internal Audit proposes a system audit of billings/receivables (collectively referred to as A/R) functions at Pier 69 by AFR. The A/R review will focus on the adequacy and effectiveness of internal controls to ensure billings and subsequent receipts are processed completely and timely. The auditor will also focus on performance risk and business continuity risk – what could go wrong to make the billing and A/R system fail? Is management aware of such risks and has put mitigation actions in place? The understanding gained through the review will also be used in other engagements, especially in department and concession audits.

2. Organizational (e.g., department) Control Reviews

The primary risk with organizational units is the efficiency/effectiveness of internal controls over accountability in managing resources including financial, compliance, and physical assets.

Throughout the discussion of the department internal control review, a reference is made to the department node. The node refers to a collection of individual departments by function and/or location.

Below is a table of **top nine operating revenue generating department nodes**, sorted by 2009 revenue in descending order. It is a good indicator of risk concentration with respect to operating revenue.

Table 1 -- Operating Revenue by Dept. Node

(in millions)

Dept. Node Description	2005	2006	2007	2008	2009*
<i>Air Terminal (1)</i>	\$116	\$128	\$129	\$125	\$103
<i>Airfield Revenues (2)</i>	\$48	\$50	\$57	\$69	\$42
Public Parking (4)	\$45	\$52	\$55	\$59	\$37
Rental Cars	\$32	\$33	\$36	\$35	\$29
Concessions Business	\$26	\$28	\$31	\$28	\$23
Container Terminal 5	\$24	\$22	\$22	\$21	\$18
Container Terminal 18	\$10	\$14	\$12	\$15	\$14
<i>Fuel Hydrant Special Facility (3)</i>	\$3	\$8	\$8	\$3	\$7
Container Terminal 46	\$10	\$10	\$10	\$12	\$6

Source: PeopleSoft

* 2009 is as of mid-October.

Explanation of the Significant Revenue Identified Above:

Air Terminal--see Table 1 (1)

Space rental and gate use charge at the airport are top two contributors in Air Terminal revenue. As such, the biggest customer in Air Terminal is Alaska Airlines from which the Port generated \$38 million dollars in 2008.

Airfield Revenues--see Table 1 (2)

Airfield revenue consists entirely of landed-weight based landing fees which are discussed in detail under revenue section of this report.

Fuel Hydrant Special Facility--see Table 1 (3)

The revenue is entirely based on land and space rentals to SeaTac Fuel Facility, LLC. The risk associated with this revenue stream is low. SeaTac Fuel Facility is a consortium of airlines at Sea-Tac. The purpose of the consortium is to acquire, operate, and maintain an aviation fuel distribution system at Seattle–Tacoma International Airport. The consortium has a lease agreement with the Port for land, tank farm, and improvements, and the current lease will expire in 2033. The lease consists of two parts: (1) facility rent and (2) payment of debt service which is paid directly to the trustee. Swissport Fueling Inc. is the 3rd party company that runs the consortium.

Terminal 5, 18 and 46 revenue streams are primarily space and crane rentals. Internal Audit proposed coverage in the 2009 work plan on crane rentals, but the project was intentionally put on hold due to the ongoing SAO performance audit over Seaport operations.

Public parking--see Table 1 (4) refers to the parking operations at the airport which generate \$50+ millions annually. Unlike other major airports, the Port does not contract out the parking operations. Landside in Aviation Division is responsible for all parking related matters. Parking at the airport represents the single largest Port-operated revenue stream. Internal Audit reviewed the operations in 2007 and proposes a review in 2010 to ensure that management has adequate controls over billing/collection and cash handling. The S&B parking system at the parking garaged is an old system and requires numerous manual adjustments – this increases the risk over cash receipting and accountability.

Although different department nodes are responsible for different agreements, much of the top nine revenue *is agreement driven*, especially lease and concession. Risk associated with lease and concession is discussed under lease and concession revenue risk exposure at a later section of this assessment.

Operating Expenses

Generally, 2009 expenses will be lower than expected as the Port implemented many cost cutting measures during the year. A 2-week furlough for non-represented employees and the across-the-board cut in travel are just a couple of examples of such measures.

Below is a table of ***top ten department nodes in operating expenses***, excluding depreciation expenses.

Table 2 -- Top 10 Dept. Nodes in Operating Expense

(In millions)

Dept. Node Description	2005	2006	2007	2008	2009*
Aviation Maintenance (1) - audit coverage in 2008	\$36	\$40	\$41	\$49	\$32
Police Department (1)- audit coverage in 2009	\$17	\$17	\$19	\$19	\$13
Information & Communication Technology - audit coverage in 2009	\$13	\$11	\$13	\$14	\$13
Air Terminal (2)	\$14	\$14	\$15	\$16	\$11
Aviation Executive/AVEX - audit coverage in 09 and proposed in 2010	\$14	\$13	\$15	\$21	\$10
Aviation Utilities – audit proposed in 2010	\$14	\$16	\$13	\$13	\$9
Maintenance (1) – audit coverage in 2008	\$9	\$9	\$10	\$12	\$7
Third Party Management – audit coverage in 2008 and 2009	\$9	\$10	\$10	\$10	\$6
Airport Security (1) – audit coverage in 2009	\$5	\$6	\$7	\$8	\$5
Accounting/Financial Reporting – annual coverage by CPA firm	\$5	\$5	\$6	\$4	\$4

Source: PeopleSoft

* 2009 is as mid-October.

Maintenance--see Table 2 (1) (Air and Seaport) and security (Police and Airport Security) are two department nodes with significant operating expenses. This is in line with the fact that maintenance as a whole is the largest operating unit at the Port. Further, maintenance operations, especially at the airport, involve a number of large contracted services (e.g., elevator and escalator maintenance contracts).

Air Terminal node--see Table 2 (2) consists of Airport Communication Center, AT Business & Lease Management, AT Services, and Aviation Marketing. The biggest expense item in the node is a janitorial services contract with ABM. The Port incurred an average of \$9 million in the past three years. Internal Audit proposes to audit this janitorial contract in 2010.

Aviation Marketing--see Table 2 (2) in the Air Terminal node has average expense outlays of \$2.5 million. Unlike other governments, the Port has numerous activities similar to those of for-profit entities. The nature of those activities often necessitates marketing of Port's products: real estate, business opportunities on Port premise and the like. Even with the acknowledgement, marketing as an activity is somewhat foreign to governments. As such, marketing at the Port is inherently risky in terms of program efficiency and effectiveness outcome. The auditor proposes auditing the Port marketing activity in 2010. We would evaluate Marketing outcome effectiveness and its impact on Port revenue etc.

Table below represents **all operating expenses by major account category** for the last five years.

Table 3 -- Operating Exp. by Account Category

(in millions)

GL Category	2005	2006	2007	2008	2009*
Salaries & Benefits (1)	\$71	\$73	\$79	\$89	\$71
Wages & Benefits (1)	\$59	\$51	\$63	\$69	\$45
Outside Services (2)	\$55	\$50	\$48	\$64	\$27
Utilities (3)	\$18	\$21	\$19	\$19	\$14
General Expenses	\$15	\$2	\$12	\$13	\$7
Supplies & Stock (4)	\$8	\$9	\$6	\$8	\$4
Equipment Expense (4)	\$5	\$6	\$6	\$7	\$2
Travel & Other Employee Expenses (5)	\$3	\$3	\$3	\$4	\$2
Other (6)	\$6	45	\$5	\$7	\$3

Source: PeopleSoft
* 2009 is as mid-October.

Payroll--see Table 3 (1)

Top ten departments in salaries and wages with benefits are listed below, and the list, expectedly, is closely related to the top ten department nodes in operating expenses.

Not surprisingly, payroll related expenses are the biggest, accounting for over 50% of the total operating expense. The Port has approximately 1,600+ employees on its payroll, and 50% of its workforce is covered by 20+ collective labor bargaining agreements. Payroll expenses are always reviewed as part of departmental audits. 2009 payroll related expenses should be lower than prior periods due to the furlough program and elimination of over 100 positions.

Table 4 -- Top 10 Dept. Nodes in Payroll Expense

(in millions)

Dept. Node Description	2005	2006	2007	2008	2009*
Aviation Maintenance – audit coverage in 2008	\$26	\$29	\$31	\$35	\$26
Police Department – audit coverage in 2009	\$15	\$15	\$16	\$17	\$12
Aviation Executive/AVEX – audit coverage in 2009	\$11	\$11	\$12	\$16	\$9
Information & Communication Technology	\$7	\$8	\$8	\$10	\$8
Maintenance – audit coverage in 2008	\$6	\$7	\$8	\$8	\$6
Airport Security – audit coverage in 2009	\$4	\$4	\$6	\$7	\$5
Air Terminal	\$3	\$3	\$4	\$5	\$4
Accounting/Financial Reporting – coverage every year	\$4	\$5	\$5	\$3	\$4
Landside	\$4	\$5	\$4	\$4	\$3
Project Controls & Admin	\$3	\$3	\$3	\$4	\$3

Source: PeopleSoft

* 2009 is as mid-October.

Currently the Port utilizes an online time entry system where original input as well as approval is processed electronically. While the online system provides mathematical accuracy and certain input validations, it presents other challenges or risks with respect to verification of completeness, proper approval, and approval delegation to staff. Approval delegation could create a conflict of interest and other accountability issues -- it's difficult to ascertain whether entries are approved with first-hand knowledge of the underlying activity. Compared to the paper-based traditional system, online systems tend to lack supporting documentation as management assumes online document is the full extent of applicable documentation requirements.

From a risk standpoint, payroll overall is relatively a closed system despite its complexities and inherent risks. The majority of payroll disbursements are based on static cost drivers (i.e., salaries, hourly rate, employment tax rates, etc.), and the volume in most cases is activity independent. Example, the daily financial liability to the Port per employee remains at 7.5/8 hours at a fixed rate whether an employee is at work or on paid time off. Thus, the size of the payroll alone will not be the primary factor in determining whether to review a particular area. The quality of payroll expenses will be a bigger factor. Risk of inappropriate compensation at the department level is not necessarily proportional to the size of payroll related expenses. Risk is more closely related to the number of organized labor (which increases the complexity of earnings activity) and department activities involving extra compensation. Ways in which the department processes payroll is also considered when assessing risk. Org. units of largely salaried employees do not pose significant risk.

At-risk in payroll are the earnings types that are collectively known as exceptional earnings (e.g., overtime and shift differentials). These represent something of above and beyond the base pay and as such require an additional compensation. The risk is whether they are proper (i.e., business related) and in compliance with applicable agreements/policies with respect to approval and documentation.

Of all exceptional earnings, overtime in particular presents a unique risk in that it poses risk not only of improper compensation but also of inefficient department operations. There is risk that overtime may be necessary because operating units are ineffective (e.g., excessive hours to accomplish simple tasks). Thus, a high level of overtime activity could suggest more than mere compensation related concerns.

Outside Services category--see Table 3(2)

Top ten department nodes in outside services category are as follows: The table indicates risk concentration in a few department nodes.

Table 5 Top 10 Dept. Nodes in Outside Services Expense

(in thousands)

Dept. Node Description	2005	2006	2007	2008	2009*
Air Terminal (1)	\$8,574	\$9,525	\$9,364	\$10,617	\$6,427
Information & Communication Technology	\$4,464	\$1,583	\$2,248	\$2,690	\$3,805
Aviation Maintenance	\$5,184	\$5,699	\$6,178	\$6,488	\$3,229
Seaport Container Operations (3)	\$509	\$176	\$204	\$2,421	\$2,762
Airfield	\$501	\$1,530	\$1,706	\$1,893	\$1,286
Public Parking (2)	\$1,918	\$2,063	\$1,504	\$1,690	\$981
Aviation Facilities	\$2,141	\$2,082	\$2,592	\$2,182	\$965
Maintenance	\$993	\$972	\$1,061	\$1,520	\$679
Port Construction Services	\$1,175	\$1,712	\$1,913	\$1,487	\$559
Legal	\$1,182	\$1,112	\$1,512	\$1,433	\$534

Source: PeopleSoft

* 2009 is as mid-October.

The outside service category is primarily of contractual services including Architectural & Engineering (A&E), non-A&E, and janitorial services. Risks with the outside services or consultant services are procurement compliance with applicable federal/state/local regulations and contracting irregularities. A&E procurements are somewhat heavily regulated in terms of solicitation and require a fair and open competitive process.

Air Terminal--see Table 5 (1) is the biggest due to a janitorial services contract with ABM. The Port incurs in excess of \$9 million annually.

Public Parking--see Table 5 (2) is included in the top ten as its payments to the bank for processing credit cards are included in the category. Other nodes are expected as the very nature of their responsibilities entail using outside professional services. Example, AV. Maintenance uses custodian and maintenance contracts, and Information Technology utilizes outside desktop support services.

T25/T28--see Table 5 (3) in the Seaport Container Operations node generally does not rank high in the services category. However, there have been activities related to the terminal 30 expansion following the relocation of cruise services in the 2009.

Utilities--see Table 3 (3)

The category is among the top five major expense categories but does not pose significant risk. There is little risk of manipulation on the expense side as consumption as a basis for payments can be easily verified with third-party independent documentation (i.e., Seattle Public Utility billing statements). Top three utilities in 2007 were electricity, heating (gas and steam), and surface water.

The risk with utilities is with consumption and consumption-driven revenues. The Port and its tenants consume the acquired utilities. Port's own usage is expensed as part of operations, but the consumption by tenants is revenue to the Port. It is either directly billed as a separate billing item or as part of rent if separate billing is not feasible. However in the billing process, there is risk that the billing rate does not reflect all components: acquisition cost, infrastructure, personnel, etc. The Port could be under billing tenants, resulting in less than full cost recovery.

Supplies and Equipment--see Table 3 (4)

Accountability is the primary risk associated with this category. Included in the category are non-capital items (i.e., equipment and supplies) which are often referred to as small and attractive items. These are items that are expensed because the monetary value is below the capitalization threshold. As such, their tracking or monitoring is not as controlled or centralized as the capitalized. However, most departments do track these items, but currently there is no established central system to monitor or ensure how well departments tract these assets. Hence, risk of loss, abuse, and misuse persists.

An additional risk element involving supplies and equipment purchases is procurement cards (P-cards). The Port has numerous procurement credit cards at many departments. As the cards tend to be used for small purchases by multiple parties, it is difficult to track both the purchaser and the purchased item. Thus, preventive and detective controls such as close monitoring of card purchases are essential to properly mitigate inherent risk of mis/abuse.

Top ten department nodes in the Supplies and Equipment Purchases are as follows.

Table 6 Top 10 Dept. Nodes in Supplies and Equipment

(in thousands)

Dept. Nodes	2005	2006	2007	2008	2009*
Aviation Maintenance	\$3,540	\$4,173	\$1,780	\$4,486	\$2,658
Maintenance	\$1,395	\$1,322	\$1,130	\$1,163	\$599
Police Department	\$293	\$315	\$309	\$504	\$187
Aviation Facilities	\$88	\$86	\$71	\$119	\$105
Engineering	\$124	\$124	\$133	\$160	\$104
Aviation Executive/AVEX	\$325	\$319	\$285	\$434	\$99
P69 Facilities Management	\$117	\$120	\$142	\$140	\$73
Public Parking	\$93	\$130	\$74	\$72	\$60
Airfield	\$34	\$64	\$11	\$90	\$35
Airport Security	\$251	\$354	\$292	\$171	\$32

Source: PeopleSoft
* 2009 is as mid-October.

Expectedly, marine and airport maintenance shops are the first two in the category. Internal Audit reviewed both maintenance shops in the last two years and suggested a number ways to strengthen existing controls over physical assets and items. Aviation Executive/AVEX is part of the top ten as the node includes the Fire Department. The majority of the supplies and equipment for the Fire are emergency supplies and uniform/protective equipment. The Fire Department is being proposed for an audited in 2010 as the department has other inherent risks (e.g., high overtime).

Engineering is somewhat unexpected in the list, but further analysis indicates that much of expenses are printing materials (paper and copier) and surveying equipment. Both types of expenses are well within expected activities of the department.

Travel and Other Employee Expense--see Table 3 (5)

The risk associated with this category is one of accountability. The category covers a wide range of expense items from breakfast to a cab ride and as such is inherently susceptible to misuse and abuse. There is a dedicated position within Accounting and Financial Reporting (AFR) for travel card expense processing which mitigates certain control deficiencies at the department level. While the position can exercise some compensating controls to ensure completeness, it does not have first-hand knowledge to determine the appropriateness of submitted expenses. This emphasizes the importance of due diligence and care by management when approving travel requests.

Top ten department nodes in the Travel and Employee Expenses are as follows.

Table 7 --Top 10 Dept. Nodes in Travel and Employee Expense

(in thousands)

Dept. Node	2005	2006	2007	2008	2009*
Executive	\$422	\$390	\$428	\$350	\$250
Human Resources & Development	\$206	\$266	\$246	\$342	\$196
Special Advisors	\$128	\$136	\$136	\$65	\$192
Aviation Executive/AVEX	\$98	\$312	\$377	\$390	\$159
Government Relations	\$154	\$117	\$128	\$145	\$97
Seaport Marketing				\$203	\$86
Information & Communication Technology	\$163	\$167	\$216	\$284	\$61
Police Department	\$147	\$125	\$173	\$155	\$58
External Affairs	\$120	\$107	\$134	\$120	\$50
Finance & Budget	\$61	\$62	\$65	\$68	\$49

Source: PeopleSoft

* 2009 is as mid-October.

All top ten are expected. Police and Fire receive heavy training which often requires traveling and overnight stays as well as registration. Special Advisors include overseas representatives and economic teams at Pier69, and thus their ranking in the category is expected.

Below is a table of the Travel & Employee Expense by general ledger accounts.

Table 8 -- Travel and Employee Expense by General Ledger Account

(in thousands)

Account Description	2005	2006	2007	2008	2009*
Membership Dues & Fees (1)	\$352	\$667	\$795	\$734	\$648
Registration Fees/Tuition	\$620	\$698	\$845	\$975	\$324
Subscriptions	\$320	275	\$250	\$335	\$193

Tuition Reimbursement-HR Only				\$97	\$122
Employee Food & Beverage	\$267	\$235	\$271	\$323	\$114
Air Fare	\$426	\$519	\$612	\$479	\$105
Local Transportation	\$65	\$70	\$72	\$116	\$62
Management Education Expense	\$20	\$29	\$30	\$28	\$38
Lodging & Other Travel	\$499	\$582	\$499	\$459	\$31
Service Awards	\$64	\$59	\$62	\$65	\$23
IDC/E&T Fellowship Program Exp				\$10	\$10

Source: PeopleSoft
* 2009 is as mid-October.

Overall, travel and other employee expenses have remained flat over the last four years up to 2008. 2009 expenses are lower as a result of certain cost cutting measures as previously mentioned in the report. No unusual trends are noted at the account level. Memberships (Table 8(1)) include big ticket dues to such organizations as WA Public Port Assoc. (~\$200,000), Airport Council International (~\$140,000), and Puget Sound Regional Council (\$34,000).

Telecommunication--see Table 3 (6)

Table 9 -- Top 10 Dept. Nodes in Telecommunication Expense

(in thousands)

Node Description	2005	2006	2007	2008	2009*
Information & Communication Technology	\$503	\$450	\$500	\$488	\$377
Police Department	\$98	\$111	\$113	\$111	\$83
Aviation Maintenance	\$100	\$105	\$81	\$95	\$71
Engineering	\$74	\$97	\$106	\$83	\$50
Aviation Executive/AVEX	\$57	\$56	\$66	\$69	\$45
Air Terminal	\$59	\$82	\$91	\$106	\$43
Maintenance	\$42	\$51	\$48	\$39	\$36
Airfield	\$35	\$44	\$48	\$45	\$32
External Affairs	\$21	\$24	\$26	\$23	\$24
Aviation Facilities	\$34	\$37	\$32	428	\$24

Source: PeopleSoft
* 2009 is as mid-October.

All top ten are expected as communication is a significant part of their daily operations. Engineering, although expected, has a bit higher than expected communications expenses.

Below is a table of the category expense by account, and no unusual trends are noted for the category as a whole. The annual communication expenses in the past 5 years on average are \$1.4 million with little fluctuation. Long Distance charges appear to have fluctuated somewhat, but further analysis indicate that fluctuations are largely due to vendor credits and year-end accounting entries. Lower than expected Data Transmission expenses appear to be due to vendor billing practices where data transmission is not separately billed.

Table 10 -- Telecommunication Expense by General Ledger Account

(in thousands)

Account Description	2005	2006	2007	2008	2009*
Telecommunications	\$1,245	\$1,308	\$1,443	\$1,338	\$1,001
Long Distance Charges	\$79	\$37	\$36	\$73	\$53
Telephone - Data Transmission	\$2	\$1	0	\$16	\$16

Source: PeopleSoft

* 2009 is as mid-October.

Promotional Expense

Promotional expenses are a subject frequently reviewed by the State Auditor's Office as the category allows such unusual items as alcoholic beverages. Internal Audit reviews the expense for any unusual trends during the assessment although it considers the coverage by the SAO adequate. In its last audit in 2009, SAO commended Port management for an effective job of monitoring and tracking promotional expenses.

Table 11 -- Top 10 Dept. Nodes in Promotional Expense

(in thousands)

Node Description	2005	2006	2007	2008	2009*
Aviation Executive/AVEX	\$239	\$179	\$427	\$1,136	\$235
External Affairs	\$280	\$134	\$196	\$176	\$61
Seaport Marketing				\$116	\$30
Community Development	\$15	\$4	\$11	\$16	\$29
Office of Social Responsibilities	\$0			\$18	\$29
Cruise Services	\$67	\$37	\$17	\$21	\$17
Special Advisors	\$63	\$59	\$38	\$54	\$16
Seaport Division Management	\$35	\$29	\$(39)	\$35	\$16
Corporate Contingencies	\$214	\$13	\$5	\$5	\$15
Executive	\$61	\$59	\$48	\$19	\$14

Source: PeopleSoft

* 2009 is as mid-October.

Other Useful Statistical Information

Below are **top five vendors in operating expenses** in 2009, and no unusual trends are noted in the list.

Table 12 -- Top 5 vendors in Operating Expenses

Ranking	Operating
1	ABM JANITORIAL SERVICES
2	SEATTLE CITY LIGHT
3	BONNEVILLE POWER ADMINISTRATION
4	GENERAL CONSTRUCTION COMPANY
5	PUGET SOUND ENERGY

Source: PeopleSoft

Below are top five non-payroll and non-utility expense accounts. Other than for 3rd management fees, it is expected that outside services as a whole are the second largest expense at the Port. Internal Audit has reviewed three 3rd party management contracts in 2008 and 2009: Bell Harbor International Conference Center, World Trade Center Club, and World Trade Center West.

Table 13 -- Top 5 Non-payroll and non-utility Accounts

(in thousands)

Acc Description	2005	2006	2007	2008	2009*
Other Contracted Services	\$18,243	\$16,422	\$10,265	\$12,700	\$7,446
Contracted Janitorial Service	\$8,101	\$8,979	\$8,733	\$9,841	\$6,214
3rd Party Mgmt Op Exp	\$7,451	\$8,408	\$8,553	\$9,324	\$5,944
Environmental Reserve Expense	\$7,739	\$(1,262)	\$5,117	\$8,889	\$3,965
Non-Architectural & Eng Svcs	\$10,925	\$7,194	\$10,309	\$14,469	\$3,175

Source: PeopleSoft

* 2009 is as mid-October.

3. Revenue (lease and concession)

Unlike other governments such as cities and counties where most revenue originates from service and property taxes, the majority of Port's operating revenue is generated based on passive earnings activity as a landlord. The Port rents land and space to various parties at sea, real estate, and airport divisions, and receives payment in return. The payment generally takes the form of: 1) a regularly occurring fixed rent amount and/or 2) a periodic settlement of a concession fee which is based on earnings activity by the lessee. The Port faces different risks depending on the type.

To elaborate further as to the extent of the passive earnings activity to the Port's overall operating revenues, a 5-year trend for agreement-driven revenue (**exclusive of landing fee agreements**) is provided below. The agreement in this context refers to fully executed written legal contractual relationships. For purposes of the analysis, Internal Audit reviewed all agreements within PROPWorks, which is an automated property and revenue management system used by both air and seaport.

Table 14 Agreement-driven Revenue

(in millions)

	2005	2006	2007	2008	2009*
Total Operating Revenue	\$ 417	\$ 447	\$ 461	\$ 484	\$ 363
Agreement-driven Revenue	\$ 258	\$ 264	\$ 303	\$ 297	\$ 287
% of Agmt-driven revenue to the Port Operating Revenue	62%	59%	66%	61%	79%

Source: PeopleSoft

* 2009 is as of mid-October

The data suggests that up to **66% of the total operating revenue** is derived from agreements. If landing fee agreements were included as part of agreement revenue, the percentage of the agreement driven revenue to the overall operating revenue would increase **to 75% or more**. Given the contribution

level to the operating revenue, the mitigation of risks associated with agreements becomes critical to the Port's overall financial health.

The most significant risk of agreement-driven revenue streams is one of completeness. It is difficult to satisfy the question regarding the complete reporting of all applicable concessionable revenue. The risk is even more evident when one considers that the majority of the agreement-driven revenue at the Port is **self reporting**. The Port has little direct means (other than an audit) to confirm or refute the reported concession base. Internal Audit has been continuously auditing the financial records of Port tenants to ensure accuracy and completeness of concession base.

Secondary risk to the agreement-driven revenue streams would be inadequate protection of Port's interest in the agreement itself. There is risk that the agreement may be executed without an audit clause. The Port would not have audit access to underlying records to determine if the reported revenue is reasonable and complete. In such cases, underreporting could continue without Port's knowledge.

In past audits, Internal Audit has found certain control deficiencies and lax management monitoring. Internal Audit has been steadily increasing coverage in the area, but given the sheer number of agreements (~620 active agreements as of Oct. 2009), it is practically impossible to review all agreements. The only effective and manageable way to consistently provide any assurance is to review agreements in some categories and set audit priority based on risk.

Below is a **5-year trend of agreement-driven revenue by major revenue category. The top three (3) cover over 80% of the total.**

Table 15 -- Agreement-driven Revenue by Category

(in millions)	2005	2006	2007	2008	2009*
Space Rental (1)	\$ 189	\$ 191	\$ 221	\$ 216	\$ 175
Car Rental Revenues (2)	\$27	\$27	\$28	\$29	\$22
Food and Beverage Revenue (3)	\$9	\$9	\$12	\$8	\$6
Retail Revenue (3)	\$8	\$7	\$10	\$11	\$8
Revenue from Sale of Utilities (4)	\$3	\$8	\$9	\$10	\$8
Land Rental	\$6	\$6	\$7	\$6	\$5
Advertising Revenue (5)	\$4	\$4	\$5	\$4	\$4
Concession Services Revenue	\$3	\$3	\$3	\$4	\$3
In-Flight Kitchen Revenue (6)	\$3	\$3	\$3	\$3	\$3
Other Misc.	\$5	\$5	\$5	\$5	\$13

Source: PeopleSoft and PROPWorks

* 2009 is as of mid-October

Space Rental (Table 15 (1)) is a low-risk area in regard to the complete and accurate receipts of the rent. Rents mostly are a fixed amount on a monthly basis. Missing and/or incorrect payments would be relatively easy to capture and remedy as the payment amount do not fluctuate monthly and is expected every month. At-risk would be a loss of revenue due to below market rents and inconsistent application/enforcement of agreed-upon provisions such as the annual acceleration clause and interest/penalty for late payments.

Rent-A-Car (RAC – Table 15(2)) - considering the total number of customers (~10), this revenue source contributes a significant amount to the operating revenue. Internal Audit has been reviewing RACs annually and found certain issues regarding gross revenue offsets. Offsets are used to reduce concessionable revenue, and thus improper offsets decreases concession to the Port. The Port has recovered well over \$1 million in past audits, but in recent audits, the extent of recovery has declined. Such decline, however, is expected as the lessees are becoming aware of the continuing audit coverage. As a result, they are less likely to manipulate the concession base. However, given the contribution to the overall operating revenue, continuing exposure is deemed necessary as a preventive measure. As such, Internal Audit has placed all RAC reviews on a 3-year audit cycle and expects to conduct a number of RAC audits in 2010. We shall continue to assess this audit approach and factor and other overall risks.

Food/Beverage/Retail (Table 15 (3)) includes shops and restaurants at the sea and airport. Prior to 2009, the revenue stream as a whole had been steadily increasing in recent years, but the trend discontinued with the current economic downturn. Internal Audit has conducted a number of reviews on big contributors in 2008 and 2009: Anthony's restaurants, Concession International, Airport Management Services, HOST, and Seattle Restaurant Associates. The reviews indicated no significant concerns. However food/beverage/retail lease agreements are often quite complex with various types of allowances (e.g., display allowance for newspapers). Further, projected decline in the travel industry due to the continuing economic downturn may create additional pressure for incomplete concession reporting. Internal Audit will continue to bring exposure to the area.

Utility resale (Table 15 (4)) is considered low risk from tenants' perspective. Risk would be an improper usage base, resulting in less than full cost recovery of original utility acquisition fees paid by the Port. Internal Audit is proposing a review of utility in 2010. The audit question is that of less than full recovery, if present, it will be addressed as part of that review.

Advertising revenue (Table 15(5)) is concession from outdoor advertising at the airport. Internal Audit reviewed concession from JC Decaux in 2007 and had a minor recovery as a result. Through a public competitive process in 2007, Clear Channel prevailed in a bid to be an outdoor advertising agent at the airport. Internal Audit conducted a review of Clear Channel in 2009 and found no significant issues.

Risk associated with land rental is similar, if not identical, to ones on the space rent as discussed above. As such, it is considered low risk.

Internal Audit reviewed all in-flight tenants (Table (6)) in 2007 and had a number of issues on disallowed offsets to concessionable gross revenue. Internal Audit will re-examine tenants in 2011 and determine if additional coverage is necessary.

Misc. includes dockage, wharfage, aviation fuel flowage, etc. Risk on these areas is similar to other concession arrangements in that fees collected by the Port may not be complete.

Below are top twenty (20) customers in 2009 in terms of total billings. Ranking has been analyzed to fully consider the agreement-driven revenue risk at the customer level.

(in millions)

Table 16 -- Top 20 customers in total billings

Rank	Name	2008	2009*	Rank	Name	2008	2009*
1	ALASKA AIRLINES INC	\$ 43	\$ 49	11	HERTZ CORPORATION	\$ 9	\$ 7
2	SSA TERMINALS LLC	\$25	\$21	12	AMERICAN AIRLINES INC	\$5	\$6
3	EAGLE MARINE	\$21	\$16	13	CONTINENTAL AIR LINES	\$6	\$6
4	UNITED AIRLINES	\$16	\$16	14	AIRPORT MGMT. SVCS	\$8	\$6
5	HORIZON AIR	\$11	\$14	15	US AIRWAYS INC	\$5	\$6
6	NW AIRLINES INC-PFC	\$11	\$10	16	AVIS	\$7	\$5
7	DELTA AIR LINES INC	\$8	\$10	17	LOUIS DREYFUS CORP	\$7	\$5
8	SOUTHWEST	\$8	\$10	18	ALAMO RENT A CAR	\$5	\$4
9	CRUISE TERMINALS OF AMERICA	\$9	\$9	19	NATIONAL CAR RENTAL	\$5	\$5
10	SEATAC FUEL FACIL LLC	\$9	\$7	20	BUDGET	\$4	\$4

Source: PeopleSoft and PROWorks

* 2009 is as of mid-October

Almost all top twenty customers are either in space or Rent-A-Car (RAC) revenue category, which is in line with the top three agreement-driven revenue categories. Analysis indicates space rental revenue is quite top-heavy in that top 10 of 500+ customers in the revenue group and accounts for over 50% of the revenue. This indicates that residual risk after the five in the space rent category is quite dispersed and under such conditions, providing adequate audit coverage may prove difficult.

The Port receives \$60+ million dollar annually in landing fees. Landing Fees are a mechanism to recover costs that are necessary to maintain and operate the airport. Fees are based on an allocation of eligible costs and billed for every 1,000 lbs of landing weight. The primary risk is potential failure to include all eligible costs in allocation pools, which results in less than full recovery of operational costs. The failure could include: 1) incorrect pooling of costs (i.e., omission of costs during the pooling process) and/or 2) incorrect general ledger account balances (i.e., incorrect costs are included). Additional risk subsequent to cost pooling would be one associated with billing and collection (e.g., late payment interest and penalty) but is not as significant as the risk of inadequate cost recovery. As with any cost recovery through allocations, there could be instances where allocations among participants may not be equitable due to errors or incorrect assumptions. While this does not present a financial risk to the Port as the Port ultimately receives all pooled costs less legitimate adjustments, it presents a risk to customer good will.

4. Federal Assistance

The Port has numerous federal grants to support various operating and capital activity. Below is a 5-year history of grant revenues. The decreasing trend is reflective of the declining construction activity associated with the third runway as well as security at both air and seaport following 9/11. The trend is expected to continue.

Table 17 -- Federal Assistance by Grantor

(in thousands)

Account	Acc Description	2005	2006	2007	2008	2009*
70810	Misc	(2,054)	(333)	(51)	(101)	0
70820	FAA	(62,157)	(73,927)	(65,555)	(37,040)	(43,156)
70825	TSA - Seaport	(44,797)	(1,399)	(653)	(780)	(932)
70830	ODP Grant Rev.	0	(870)	(50)	0	0
70835	TSA - Airport	0	(42,526)	(19,448)	(4,248)	(11,159)
70840	DOT	(564)	(6,991)	(3,827)	(2,084)	(134)
70850	WA State	(82)	(1,148)	74	(25)	0
70860	DOE	0	0	0	0	0
Total		(109,655)	(127,194)	(89,511)	(44,280)	(55,382)

Source: PeopleSoft

* 2009 is as of mid-October

When federal assistance as a whole exceeds \$500,000, an audit of federal expenditures is required per the Single Audit Act of 1984, as amended. An independent CPA firm typically performs the audit. Currently Moss Adams is Port's independent auditor and conducts the single audit annually.

The Port has not had any significant findings related to federal grants. Internal Audit considers the audit by Moss Adams of federal expenditures adequate, and as such the department has no plan to conduct any procedures related to the federal grants in 2010.

5. 3RD Party Management Contracts

Risk is one of compliance. The requirements to which the Port is subject are the same requirements with which the 3rd party management must comply as an extension of the Port. Any noncompliance by the 3rd party management is, by extension, noncompliance by the Port. Based on past coverage, Port management and the 3rd party management companies appear to lack the knowledge that all 3rd party transactions are under the same degree of public scrutiny as transactions going through Port systems. Internal Audit has reviewed all but one 3rd party, Port Café.

Internal Audit plans to review Port Café in 2010.

6. Performance

Establishment of performance measures generally precedes performance audits. Once instituted for a period of time, operations can be measures against those established matrix or the matrix can be benchmarked against industry standards to determine efficiency and effectiveness in the achievement of goals and objectives.

The Port has not fully established performance measures in many of its operations/departments, and thus the traditional approach cannot be used to conduct performance audits. However, the Port does have numerous measurable indicators of performance expectations. For example, an annual budget and expectations of job creation could be viewed as such indicators. Put it differently, a performance

audit can be conducted with the budget, specific requirements/law and management expectations as a baseline performance measure.

The Audit Committee continues to support audits with performance aspects and has asked for increases in performance auditing coverage. In line with the Committee expectations, Internal Audit has embedded a performance aspect into all audits, where feasible. Moreover, in an effort to strengthen proficiency of all Internal Audit staff in performance auditing, the department has gone through a 3-day training course on performance auditing. The senior auditors and Internal Audit management have also taken a 2-day intense training on operational audits.

Internal Audit plans to significantly increase coverage on performance audits in 2010; however for performance audits to be successful, management needs to establish define criteria against which operations or effectiveness can be measured against.

7. Financial Reporting/General Ledger

Accounting and Financial Reporting, formerly known as APS, prepares annual financial statements (Comprehensive Annual Financial Report) as of and for a period ending December 31. The statements are annually audited by an independent CPA firm, Moss Adams, for reasonableness and fair presentation.

The risk of material misstatement in the government financial statements is considered low. In a manner of speaking, there is little incentive to “cook” the books. More relevant would be the disclosure risk in regard to the nature and extent of the content of the statements, but Port accounting and financial reporting staff has the expertise to adequately mitigate the risk. For the past three years, the Port has received GFOA Certificate of Achievement for Excellence in Financial Reporting.

Internal Audit has no plan to conduct any review in the upcoming year related to the financial statements or reporting.

8. Enterprise Risk Management (ERM)

The Audit Committee has repeatedly expressed interest in implementing an ERM system at the Port. The Committee, management, and Internal Audit recognize the value of ERM as a tool in streamlining Port-wide efforts to effectively manage risks. The Committee has included ERM as one of its strategic goals for the next five (5) years.

At the time of this assessment, no formal ERM system has been implemented at the Port (i.e., no ERM system to review). Thus, risks associated with not having a formal ERM or substantially equivalent system remains outstanding. However, it should be noted that there are silos of risk assessments conducted by many work units and/or departments throughout the Port. The 2009 departmental audits indicated that departments do have elements of a risk assessment as part of the management control structure, but they tend to be informal and fragmented. Hence there is a need for training and coaching Port staff in this area because there is likelihood that some risks that might have a negative impact on the work units may not have been identified and/or considered. ERM is a top-down process and as such, support from all levels is essential to the success of any ERM processes.

Even in the absence of a formal ERM process at the Port, the risk management element of the ERM will continue to be part of all internal audits engagements. The question regarding how systematically risk is being managed has been and will continue to be an integral part of all Internal Audit reviews.

As noted in the Emerging Challenges/Issues section of this document, in November of 2009, Port management presented to the Audit Committee that it would conduct an ERM pilot project in 2010. As part of that pilot project, templates and standard expectations will be developed for utilization by all Port work units. Hence, meaningful discussions of the ERM implementation at the Port will likely occur following completion of the pilot project. Internal Audit will continue to work closely with management and to monitor the efforts of the ERM pilot project. We would expect a status update to the Audit Committee probably by July of 2010.

9. Special Investigation and other Requests

The Port considers any allegation of fraud and loss of public funds as a serious infringement of public trust and investigates fully and diligently if determined there is substantial merit to the allegation.

At the time of the assessment, Internal Audit is uncertain as to the extent of the special investigation in the coming year. However, Internal Audit acknowledges that there will be some and consequently reserves a certain level of audit resources in the work plan dedicated to such investigations.

10. Capital Improvement Program (CIP)

In recent years, there has been a significant amount of exposure on the contracting practices at the Port. A number of external and internal audits have been conducted in the area including the Port-initiated performance audit and the 2007 State Auditor's performance audit, to name a few.

Based on the findings (especially from the SAO performance report), the Port has reorganized and created a new division, Capital Development Division (CDD), to ensure improved efficiency and compliance. CDD has been instrumental in drafting and implementing new policies and procedures to strengthen and supplement existing ones. Based on our last review, up to six CPO policies and procedures have been developed lately. Further, the revised policy on personal and professional agreements and the revamped policy on delegation of administrative authority (Resolution 3605) are a couple of examples of such efforts.

Given the level of changes in recent years, Internal Audit had deferred additional scrutiny of this area. Now that CDD has had time to mature, and there has been sufficient time for new policies and procedures to root, a review is warranted to ensure the changes are realizing intended benefits. The director of the Capital Development Division (CDD), and the Port CEO have asked for a review of this area in 2010 and Internal Audit concurs with that request. The CDD director and Internal Audit have developed an outline of the areas the audit will focus on. The audit will focus on capital project program from planning, design, construction, and close-out. Specific emphasis will be given to the Corrective Actions that Port management has undertaken since the 2007 SAO performance audit.

Summary of Risks

Risks are events that have some probability of occurring. Risk measurement involves subjective judgment and reference to objective or historical data. The measurement of risk is accomplished by measuring a number of factors related risks such as: complexity, regulatory, technology, dollars amount at risk, liquidity of assets, competence of management, strength of internal control, monitoring activities, frequency of internal audits etc. Internal Audit is very experienced with Port operations, including Washington State local government operations and requirements. We will use that experience and our professional judgment to measure and prioritize the risks facing the Port.

Below is a summary of risks identified at the Port. These risks are not listed in any particular order of significance.

Table 18 Summary of Risks

Risk No.	Fact	Risk	Risk Measurement or Likelihood of Occurring	Auditor's Action Plan or Response	See Detailed Work Plan
#1	The Port is subject to a number of state statutes regulating many aspects of its operations. Government regulations are an inherent risk of any public agency.	Non-compliance with state statutes	HIGH	Review of Federal/State/Local legal compliance is embedded in all our department audits.	2010 department reviews
#2	The Port is a public agency – that is audited annually by SAO	Findings on the Port could create a negative publicity about the Port.	HIGH	Accountability and transparency concerns of a public agency are embedded in all our department audits.	2010 department reviews
#3	The Port is audited by other state or local agencies such as DOR, Departments of Retirement, Local Unions, IRS etc.	If the Port was found to owe money, this could have a negative publicity and or financial impact on the Port.	MODERATE	Continue monitoring audit activities/results by these agencies and modify, as warranted, the department A.R.A.P. and work plan accordingly.	
#4	The Port environment is complex and decentralized.	Inadequate controls, ineffective monitoring in achieving Port objectives, and	HIGH	Continuous monitoring of key indicators of inadequate controls, ineffective monitoring by management, and	2010 Department internal control reviews and systems review.

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		possible non-compliance		modify, as warranted, the A.R.A.P. and work plan accordingly.	
#5	The majority of Port tenants and customers have a self reporting system.	Underreporting of Concession fee and lack of monitoring by Port management.	HIGH	Continue to monitor the effectiveness of the Port management monitoring systems and promote awareness on compliance.	2010 revenue reviews.
#6	Operating procedures for business units are not always visible.	The procedures may not line up with the Port overall policies and strategy.	HIGH	The adequacy of policy/procedure is an integral part of all department internal control reviews.	2010 department reviews.
#7	The Port has many stand-alone IT subsystems.	Lack of reconciliation with the Port financial system - PeopleSoft	MEDIUM	Sub-systems and their reconciliations are reviewed as part of the department internal control reviews.	2010 department reviews.
#8	The Port receives federal financial assistance.	Non-compliance with grant requirements	MEDIUM	The department considers the work by Moss Adams adequate.	
#9	The Port is decentralized and has many local policies and procedures.	No-compliance and lack of adherence to Port policies and strategies.	MODERATE	The adequacy of policy/procedure is an integral part of all department operational audit	2010 department reviews.
#10	the Port created new operational units and positions – Department of Social Responsibility etc.	Operational risk as new units and positions establish and line staff acclimate	LOW	Vigilant to indicators (financial or otherwise) of systematic or control failure.	2010 department reviews
#11	The Port is upgrading or replacing some of IT systems.	With system implementation and/or upgrades, there is always an inherent risk that something might go wrong.	MEDIUM	Increase Internal Audit participation in system implementation discussions as well as post-implementation risk assessment	
#12	The Port implemented a fraud hotline in 2008.	Case reported through the fraud hotline may affect Internal Audit workload	MEDIUM	Increase Internal Audit resources	Most of the hotline cases have been addressed by the legal department.

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#13	State Initiative 900 – Performance Audits	Negative publicity on the Port	MEDIUM	Provide assistance to management on proactive issue mitigation prior to the performance audit. Following the audit report, issue follow-up per the Audit Committee directions.	2010 department reviews and performance audit.
#14	The Port spends millions each year on capital expenditures.	State and federal non-compliance and/or kickbacks. Capitalization of inappropriate charges.	HIGH	CIP is one of Internal Audit's top ten risk exposures and as such the area is reviewed regularly for any indications of lack of controls, transparency, and or accountability risk.	2010 performance audit.
#15	The Port has many remote cash receipting locations.	Misappropriation and/or fraud of public funds	HIGH	The cash receipting review is included as part of the regular department internal control review if the department has a receipting operation.	2010 performance audit.
#16	The Port has many tenants that provide food and retail services.	Underreporting of concession fee to the Port.	HIGH	Ongoing and active risk assessment on concession agreements.	2010 performance audit.
#17	Space rental is the leading major source of revenue for the Port.	Tenants might not pay space rent to the Port	LOW	Ongoing and active risk assessment on concession/rent agreements	
#18	A lot of receipts are collected over the counter at the Airport Public garage.	Cash /checks are by nature susceptible to theft and fraud.	HIGH	Internal Audit reviewed this area in 2007.	2010 performance audit.
#19	Rental car agencies tend to give unallowable rebates and discounts to their customers.	Underreporting of concession fee to the Port.	HIGH	Continue auditing rental cars agencies and leases with a focus on effectiveness of management monitoring controls	2010 performance audit.
#20	The Port has four operations that are managed through third party	Non-compliance with state and local laws, and risks of	HIGH	3 rd party management contracts are one of Internal Audit's top ten risk exposures	2010 Pier 69 Café audit.

	management services.	accountability and transparency .		and as such the area is reviewed regularly for any indications of lack of controls or accountability risks.	
#21	Payroll or payroll related expenses comprise over 50% of Port operating expenses.	Management often delegates approval authority to staff - it's difficult to ascertain that entries are approved with first-hand knowledge of the underlying activity	MODERATE	Payroll was part of the 2009 work plan as a system audit review and the focus is operational effectiveness.	2010 work plan - proposed review of billings and account receivables (A/R)
#22	The Port spends over \$100 million in consulting services annually.	The primary risk with the outside services or consultant services is compliance with the Port policies and or state laws. Contract irregularities.	HIGH	Procurement was reviewed in 2008 which was followed by a system audit of accounts payable in 2009. The focus of the audits was management operational effectiveness.	2010 performance audit of CDD (Capital Development Division) and 2010 department reviews
#23	The Port spends quite a bit of money on supplies and equipment.	The primary risk associated with supplies & equipment is accountability. There is a risk of theft and/or abuse.	HIGH	Supplies and equipment are part of the department operational audit.	2010 department reviews.
#24	The Port spends over \$3 million annually through P-card procurement.	Abuse of credit cards for personal gain and/ or personal purchases.	HIGH	Procurement was reviewed in 2008 and was followed by a system audit of accounts payable in 2009.	2010 department reviews.
#25	The Port spends materially on employee travel and other related expenses.	Accountability risk and/or abuse	HIGH	Travel and other related expenses are part of the department internal control reviews.	2010 department reviews.
#26	The Port sells its surplus equipment annually.	The sale might not be arms length transaction.	MODERATE	Scrap sale was reviewed in 2008 as part of the Av. Maintenance review. 2009 Work Plan also covered this area.	
#27	The Port prepares	Material	LOW	The risk of material	Accounting

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	annual financial statements/CAFR.	misstatement in the financial statements		misstatement in government financial statements is LOW	Department has competent staff to mitigate this risk.
#28	The Port has reduced the budget and staff.	Added pressure to do more with less. Due diligence over accountability, compliance, and performance may lax.	HIGH	Continuous monitoring and heightened skepticism by Internal Audit; Increase vigilance by management on expenses.	2010 department reviews for potential impact
#29	Continuing economic downturn	Added pressure for non-compliance on the part of the lessee. Added pressure for Port staff to “cut corner” in performance as FTE (full time equivalents) and expenses are reduced.	HIGH	Continuous monitoring of expense and agreement revenues, and heightened skepticism by Internal Audit.	2010 department and performance reviews.
#30	Voluntary Separation Program	Loss of institutional memories and expertise, resulting in operation inefficiency and ineffectiveness.	HIGH	Continuous monitoring and heightened skepticism by Internal Audit. Timely recruitment by management to fill key vacant positions	2010 department and performance reviews.

Risk Assurance

2010 Proposed Audit Coverage

The audit coverage for 2010 includes the following areas whose coverage is determined by two factors: 1) risk as discussed in previous sections of this document and 2) available audit resources. The coverage will be adjusted as necessary throughout the year.

Carryover Audits from Fiscal Year 2009

The following lease and concession agreement reviews were not completed in 2009 due to scheduling conflicts and workload.

- REPUBLIC PARKING NORTHWEST INC
- AIRPORT MANAGEMENT SERVICES LLC

System Audits

Internal Audit proposes a review of billings and receivables in 2010. The review will focus on operational effectiveness and management monitoring controls.

The centralized billings/receivables process all concession billings and incoming payments. As concession billings account for a significant part of Port's overall operating revenue, control gaps and failures at the centralized billings/receivables could have a material impact to the Port's financial position.

As discussed under the ERM section of this document, Internal Audit will continue to incorporate elements of ERM, where feasible, into the scope of the system audits. This will be in addition to the internal control review over significant risks, which is the usual scope of the system review.

Department Operational Audits

Internal Audit recommends the following department reviews in 2010. It should be noted that Internal Audit conducts risk-based audits. Although the department review includes all aspects of department operations, only the areas of perceived high risk within the department are included in the scope. Additionally, performance and ERM elements will be part of department reviews, where feasible.

- SeaTac Utility

The Port incurs approx. \$12 million annually in acquiring utilities to operate various facilities. Top three utilities are electricity, heating (gas and steam), and surface water. The Port is both a provider and a consumer of utilities. The Port consumes about 75% of the acquired utilities, and the remaining 25% is for tenants.

The consumption by tenants is either directly billed as a separate billing item or as part of rent if separate billing is not feasible. Given the current billing practices, there is risk that the billing rate does not reflect all components: acquisition cost, infrastructure, personnel, etc. Less than a fully loaded billing rate could result in insufficient cost recovery.

Internal Audit proposes a department review to ensure that adequate controls exist over utility operations including billing.

- Marketing (Aviation and Seaport)

Unlike other governments, the Port has numerous activities similar to those of for-profit entities. The nature of those activities often necessitates marketing of Port's products and services (e.g., real estate and business opportunities on Port premise). Marketing as an activity of a government is inherently risky as its role is not well defined within the framework of government services. Thus, there is risk of ineffectiveness.

Internal Audit endeavors to provide consistent and complete coverage of a certain type of operations every year. In the past, such an approach was used with In-Flight meal, concessions, and cash receipting, security, recreational boating etc. As a result, Internal Audit was able to provide the Committee and management with an assessment on similar operations as a whole and on individual parts.

In 2010, Internal Audit proposes a review of Port's marketing activities at both Aviation and Seaport to determine the efficiency and effectiveness of marketing activity as a whole. For example, what relationship and impact does marketing activities have on Port container operation, cruise business, and airport airlines? Are those marketing efforts effective in achieving Port objectives?

- Public Parking at the Airport

Parking operations generate over \$50 million annually. It is the single largest Port-operated receipting operation. Internal Audit reviewed the operations in 2006 and found a number of weaknesses in the handling of billing, receipting and cash.

Given the inherently risky nature of the cash operation and its contribution to the overall operating revenue, the parking operations must be reviewed regularly to ensure proper billing/receipting of all parking revenues. Internal Audit proposes a review of parking operations in 2010 to continue the regular coverage of inherently risky cash operations.

- Fire Department

Much of the department's operating expenses are wages and benefits to provide the around-the-clock emergency services coverage at the airport and surrounding Port's properties. In efforts to meet such demand, the department utilizes a group of non-regular hours including overtime and standby. In 2008, the department logged in over 12,000 and 3,000 hours for overtime and standby hours, respectively. In addition, necessary training and equipment purchases in performing the emergency services are considered inherently risky with respect to accountability (e.g., approval, business purpose, and procurement compliance).

In providing essential emergency services at the airport, the department is involved in a number of inherently high risk activities from an internal control perspective. No audit has been conducted in this department operations to ensure that department controls are adequate and sufficient. We propose an audit of this department in 2010.

- Fishermen's Terminal

Fishermen's Terminal includes a number of operations: 1) commercial vessel management, 2) recreational boating, and 3) terminal operations. The department on average generates \$4.5 million annually from a variety of revenue sources including lockers, space rental, moorage, and equipment rental. The department incurs approx. \$1.5 million in expenses of payroll, utilities, and outside services (i.e., security guards). A risk associated with expenses as a whole is not considered significant, but there is a significant operational risk related to revenue streams, given the nature (i.e., large customer base on a regular basis) and the extent (i.e., over \$4 million).

Internal Audit has never audited this department and we propose to audit it in 2010. Further certain controls weaknesses over receipting were called out by SAO in its 2009 audit.

Lease Compliance Audits

To provide adequate coverage for the biggest single source of revenue to the Port, Internal Audit will continue to maintain a level of presence and cycle audits in this area.

In the past three to five years, Internal Audit reviews have been primarily based on the contribution (i.e., \$\$) to the overall operating revenue. More audit attention/coverage has been given to the biggest contributors of the concession revenue. In 2010, the focus is shifting a bit in that the past audit coverage (i.e., audits by Internal Audit) is weighted equally as the contribution. Medium contributors, who have not been reviewed, have been given equal consideration for audit coverage.

Internal Audit proposes reviews of the following lease agreements in 2010.

- Qdoba
- Pallino Pastaria.
- Smarte Carte
- Sodexho America, LLC.
- Crane Rentals - EAGLE MARINE, STEVEDORE SVCS, and TOTAL TERMINALS
- Landing Fees

Rent-A-Car (RAC) Audits

For the past 4 years, Internal Audit has conducting RAC audits and recovered a significant amount of underreported concession.

The ownership of rental companies has changed and as a result, Internal Audit adjusted its 3-year audit cycle. For 2010 coverage, Internal Audit recommends the following RAC agreements for review. These are the small RAC agencies that have not been given audit attention in the past.

- FOX Rent-A-Car

- DTAG (dba Thrifty)
- CMC INVESTMENTS INC. (dba Dollars)

3RD Party Management Contracts

In 2008 and 2009, Internal Audit reviewed all 3rd party contracts except Pier 69 Café. Past audits indicated certain non-compliance and monitoring issues on the 3rd party contracts.

The café is managed by Consolidated Food Management and generates revenues based on sales to the public (i.e., walk-in Clippers customers) and Port employees. For calendar year 2008, the operation generated revenues of ~\$275,000 with offsetting expenses of ~\$454,000, which resulted in a loss of ~\$179,000 for the year – this means that the Port is subsidizing this operation. Since the current management contract is up for renewal in June 2010, we propose auditing this management agreement early in 2010 in order to identify any significant issues that might need to be addressed in the upcoming RFP.

Performance Audits

Internal Audit proposes the following performance audits in 2010:

- Post 2007 performance audit Contracting Practices at Capital Development Division (CDD) - Effectiveness

Post 2007 audit policies and procedures have matured to a point where an in-process review could be valuable in assessing how effective action to date has been. Such a review will examine, in detail, the condition/cause as indicated by the SAO report but, more importantly, examine the post audit management response thus far implemented for its effectiveness.

The proposed performance audit aligns well with the proposed coverage of the capital improvement area.

- Office of Social Responsibility (OSR) - effectiveness

OSR was created as a result of a CEO initiative to “inspire commitment and assure that all Port business actions are conducted within a framework of socially responsible values such as fairness, inclusion, openness and economic development for all.” The intent was to centralize programs designed to be socially responsible as a public agency. Example, OSR has been spearheading a program to promote small business participation in business opportunities with the Port.

Internal Audit conducted a risk-based review of OSR operations in 2009 and noted certain compliance issues. Internal Audit proposes a performance review of its programs in 2010 to examine its effectiveness: are department programs in line with the department mission and achieving intended results? What impact (increase in small business participation) has occurred as a result of establishment of OSR?

- ABM contract (Aviation terminal janitorial services) - effective monitoring

The Port incurs in excess of \$9 million annually for janitorial services at the airport. The airport is a 24/7 operation, and janitorial services must also be 24/7 in order to support the operation.

It is difficult to effectively monitor the extent of services by ABM as the company covers rather large areas at the airport around the clock. While the end result of ABM services is rather obvious and transparent (i.e., airport is either clean or dirty), the extent of services provided with respect to efficiency/effectiveness is not as easy to gauge. In the past, the Port assumed integrity in self-reported information by the contractor and relied on it to assess service effectiveness/efficiency. However, there had been indications that such assumptions might have been misplaced. There were errors and, in certain instances, the contractor was not able to substantiate hours. Such inadequacies were acknowledged and addressed in the current contract where fees for services are now fixed (i.e., regular payments of a fixed amount). Thus, the risk associated with a variable service base (i.e., hours) has gone away. However, the difficulty in assessing service efficiency/effectiveness persists: How is management monitoring the agreement to ensure that the payment is commensurate to the extent of services provided?

Given the size of the expenses (ABM is the largest vendor in operating expenses – see Table 12 Page 27) and potential risk of inefficient/ineffective services, Internal Audit proposes a review in 2010 to ensure management monitoring of the contractor is adequate and effective.

- Overtime at Aviation Departments – efficiency/effectiveness

By its very definition, overtime is either a shortage in workforce and/or unexpected (usually short term) surge in workload. Either case, overtime presents a challenge to management. The expected staff shortage as a result of the workforce reduction through eliminations and the VSP program may necessitate a level of overtime in 2010. In other words, overtime pressure in 2010 could be higher than previous years to meet the workload because of the diminishing workforce. Consistently high overtime could be an indication of abuse and/or inefficient staff resources.

There are a number of departments such as Fire and Police where a certain level of overtime hours is expected due to the nature of the responsibility. However, even in such departments, efficiency/effectiveness could be questioned.

- Is overtime necessary?
- Do other paid-time-off hours (e.g., vacation and sick) necessitate overtime?
- Have there been instances where the Port incurred overtime for the convenience of the employee?

Internal Audit proposes a review of overtime in Aviation Division to assess such questions. Aviation management has also requested an audit in this area.

- Crosscutting Programs

The following programs are not concentrated in any one particular department; rather, they are elements found to be part of operations in many departments across the Port.

- Misc. Receipting - safeguarding and compliance

Internal Audit has reviewed most of major receipting sites to ensure adequate controls and accountability. However, the same degree of coverage has not been given to a group of receipting sites that do not process significant amounts of money. The proposed audit will treat those separate sites as one program and review operations to ensure that Port assets are adequately safeguarded.

o Fleet Maintenance – efficiency/effectiveness

The Port has a fleet of vehicles, and a great deal of maintenance is performed internally by maintenance departments. The proposed review is to examine whether maintenance efforts are efficient and effective. This is a review where benchmarking is feasible against well accepted industry best practices. Staff and budget cuts in 2010 budget could compound the risk of inefficiency.

o Cell Phone - efficiency/input to output

There are 1000+ unique mobile numbers at the Port with all major carriers. Mobile numbers include cell phones and air cards which are mostly for Police patrol vehicle laptops. AT&T is currently the biggest carrier with 500+ accounts. An analysis indicates that the Port staff logged ~39,000 hours in 2008. Given such wide usage, Internal Audit proposes a review to determine if mobile devices as an input are producing an outcome of effectiveness. Additionally, the review will examine staff qualification for cell phone issuances and whether the Port is acquiring such devices (inclusive of calling plans) economically.

Continuous Monitoring

As alluded to under the control environment discussions, the Port utilizes numerous information technologies to maximize efficiency. While such assets create their own risks, they also bring certain positive and promising aspects to auditing processes. Specifically, modern technology enables auditing professionals to examine certain classes of transactions real time and online. Auditors can apply preventive as well as detective procedures essentially at will. The process is referred to as continuous monitoring and is part of internal auditing best practices.

Internal Audit proposes the following continuous monitoring procedures in 2010:

- Vendor and Employee - to prevent conflicts of interest and to detect ghost vendors
- Request for Payment - to detect policy noncompliance and non-Port business outlays

Internal Audit will implement continuous monitoring in 2010. The intent is to build a robust continuous monitoring system as an integral part of Internal Audit's continuous risk assessment process.

Follow-Up of Significant Prior Audit Issues

Internal Audit has conducted numerous operational and compliance audits and had a number of issues of varying significance. In the past two years, Internal Audit has not conducted any follow-up reviews to provide management with an ample time to design and implement necessary controls to address the issue. By 2010, a sufficient time will have elapsed, and thus Internal Audit proposes a series of follow-up reviews in 2010:

- Aviation/Sea Maintenance – inventory

- Ground Transportation - revenue completeness
- ID Badging - receipting/system weaknesses

The Way Forward

- Consistent with the Audit Committee's strategic goals over the next five years, Internal Audit will continue to increase its coverage on management and program from a performance audit perspective. A significant increase in performance auditing is proposed for 2010. Concurrently Internal Audit will continue to incorporate, where possible, performance audit elements into all reviews the department conducts.
- Port activity is replete with risks and rewards. Rewards are realized if risks are efficiently and effectively managed. In this context, Enterprise Risk Management (ERM) has been discussed as a tool to streamline the Port's risk management practices. ERM is an enterprise-wide effort, and as such it takes management commitment to successfully implement and reap full benefits. Internal Audit will continue to participate, while maintaining independence, in ERM discussions with management. Once fully implemented, Internal Audit will review the system to determine the effectiveness and efficiency.
- Internal Audit reviews are planned and conducted based on risk (i.e., risk-based). No audit procedures are designed and applied without first considering the nature and extent of risk associated with the review subject. In line with the Committee direction, Internal Audit will expand the risk-based and integrate an element of ERM into its audits.
- One of the unique aspects of the Port is that it is financed with public funds as a public entity although much of its activity is with the private sector. As such, the Port has no shortage of compliance requirements from all levels of governments based on public expectations. Simply stated, compliance risk associated with being a public entity (i.e., public accountability and legal compliance) will always be part of the Port's risk landscape. Given that, any ERM system the Port management ultimately implements will have to have an element to address accountability, transparency, and legal compliance.
- Much of the oversight on accountability at the Port is performed by Washington State Auditor's Office either through annual accountability or scope-based performance audits. Internal Audit as a group has over 30 years of public entity audit experience in the state and understands very well the kinds of concerns the SAO would have in conducting these audits. Using that knowledge, Internal Audit will continue to provide assistance to management with respect to the SAO audit process while maintaining independence.

References

The auditing standards below provide some guidance on the auditor's assessment of risks. Although these standards are more closely related to financial statement audits, concepts & application are very much applicable to the process used in our A.R.A.P.

- SAS No. 104 – Amendment to SAS No. 1, Codification of Auditing Standards and Procedures (“Due Professional Care in the Performance of Work”)
- SAS No. 105 – Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards
- SAS No. 106 - Audit Evidence
- SAS No. 107 – Audit Risk and Materiality in Conducting an Audit
- SAS No. 108 – Planning and Supervision
- SAS No. 109 – Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement
- SAS No. 110 – Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained
- SAS No. 111 – Amendment to Statement on Auditing Standards No. 30, Audit Sampling
- 2007 Yellow Book.
- 2009 International Professional Practice Framework (IPPE)
- SAS No. 99 – Superseded SAS 82, Consideration of Fraud in a Financial Statements Audit - defines fraud as an intentional act that results in a material misstatement in financial statements.
- SAS 112 – Single Audit (A-133)
- SAS 115 – Change in definitions only
- Enterprise Risk Management – 2004 COSO Integrated Framework and related updates