

Port of Seattle

2010 Audit Engagement Service Plan

Presented to the Audit Committee on October 5, 2010



MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

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SCOPE OF WORK

The purpose of our audit engagements is to form an opinion on the fairness of presentation of the financial statements of the Port of Seattle for the year ended December 31, 2010 in accordance with accounting principles generally accepted in the United States of America and to audit and report on the administration of federal awards received by the Port in accordance with Federal Circular OMB A-133. The audits will be performed in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*.

The following summarizes the services to be provided:

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

OUR AUDIT APPROACH

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

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

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

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

Phase I - Planning

The following risk assessment activities are performed:

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

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

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

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

Materiality

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

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

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

Non-Posting Threshold for Trivial Matters

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

Phase II - Assessment of Internal Control

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

- Obtain and assess the Port's entity-level controls including the information technology environment and the effect on the internal control structure.
- Identify significant accounts and processes:
 - ❖ Administration of federal awards and related administrative controls
 - ❖ Billings, cash receipts, and receivables
 - ❖ Signatory Lease and Operating Agreement
 - ❖ Procurement, cash disbursements, and payables
 - ❖ Payroll
 - ❖ Capital projects
 - ❖ Treasury and investments
 - ❖ Debt and related accounts
 - ❖ Pollution remediation obligation and contingencies
 - ❖ Third party management
 - ❖ Financial close and reporting
 - ❖ Information technology (general computer controls)
 - ❖ Budget

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

Phase III - Substantive Audit Procedures

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

Test of Details

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

Analytical Procedures

- In the planning phase, we perform a comparison of current and prior year results and actual and budgetary information, as well as a comparison of industry benchmarks to your results.
- During substantive testing, we perform an analysis of the detail of changes to certain accounts such as capital asset, long-term debt, and investment accounts. For other accounts, we frequently use predictive analytical tests such as using specific data to develop expectations.
- At the conclusion of the audit, we do a holistic review of the financial statements in light of the results of other auditing procedures and assess whether we have appropriately addressed all critical areas.

Conferences and Audit Progress Reports

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

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

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

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

AUDIT, ACCOUNTING, AND REPORTING ISSUES

We have highlighted certain accounting issues pertinent to the Port:

Bond Accounts

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

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

Leases

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

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

Revenue Recognition

Revenue recognition complexities:

- Signatory Lease and Operating Agreement (SLOA)
- Other operating revenue
- Tax, PFC and federal grant receipts, and investment income

Capital Assets

Capital assets issues and related accounts:

- Capitalization policies and classification of work orders
- Asset retirements and demolition
- Project costs and overhead allocation
- Depreciation expense
- Impairment analysis

Pollution Remediation Obligations

Pollution remediation complexities include:

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

NEW ACCOUNTING PRONOUNCEMENTS

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

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

GASB Statement No. 59, “Financial Instruments Omnibus”, effective for the Port in 2010, updates and improves existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The requirements are intended to improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarifications of existing standards.

Statement on Auditing Standards No. 117, “Compliance Audits”, effective for the audit of the Port in 2010, establishes standards and provides guidance on performing and reporting on an audit of an entity’s compliance with applicable compliance requirements of a governmental audit requirement. The statement reflects changes in the compliance audit environment and incorporates the risk assessment standards.

Statement on Auditing Standards No. 118, “Other Information in Documents Containing Audited Financial Statements”, effective for the audit of the Port in 2011, addresses the auditor’s responsibility in relation to other information in documents containing audited financial statements and the auditor’s report. While the auditor has no responsibility for determining whether such information is properly stated, this statement establishes the requirement for the auditor to read the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and the other information.

Statement on Auditing Standards No. 119, “Supplementary Information in Relation to the Financial Statements as a Whole”, effective for the audit of the Port in 2011, provides guidance on the inclusion of an opinion as to whether supplementary information is fairly stated in relation to the financial statements as a whole.

Statement on Auditing Standards No. 120, “Required Supplementary Information”, effective for the audit of the Port in 2011, addresses the auditor’s responsibility with respect to information that a designated accounting standard setter requires to accompany an entity’s basic financial statements.

AUDIT TIMING

AUDIT SCHEDULE	TIMING
Audit Planning	
Meet with your management and accounting staff to set up the year-end audit timeline, identify and resolve pertinent issues, perform a risk assessment, and address any concerns of management or members of the audit committee or Port Commission.	September - October 2010
Provide management with a detailed comprehensive list of account analyses and other materials to prepare prior to the start of the audit. Work closely with those involved in the audit process to clearly identify roles and responsibilities during the audit.	October 2010
Meet with the Audit Committee to provide an overview of the planned scope and timing of the audit in our engagement service plan.	As requested; no later than December 2010
Meet with Port management to discuss new Port transactions or activities and new or pending accounting and auditing guidance.	Quarterly
Audit Fieldwork	
Perform interim field work to perform testing of the Port's internal controls and to facilitate planning for year-end audit fieldwork. Test certain accounts such as revenue recognition, leases, environmental liabilities, and construction in progress.	October to December 2010
Perform procedures related to administration of federal awards in accordance with Federal Circular OMB A-133.	October 2010 to December 2010 and March to April 2011
Perform the year-end audit fieldwork of the Port's account balances (financial statement audits and testing of Schedule of Federal Awards).	February to April 2011
Perform the audit on PFC receipts and expenditures and related internal controls.	March to April 2011
Report Preparation	
Issue our opinion on the financial statements and schedule of Net Revenues Available for Revenue Bond Debt Service.	On or before April 30, 2011
Issue Single Audit reports and PFC program audit report.	On or before June 30, 2011
Issue the draft management letter of recommendations.	On or before June 30, 2011
Meet with the Audit Committee and management to present audit results.	As requested; no later than June 30, 2011

MOSS ADAMS AUDIT TEAM

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



Laurie J. Tish, CPA, Business Assurance Partner

Laurie is an audit partner in the Governmental Services Group. Laurie has specialized in serving governmental entities since she began her career in public accounting 27 years ago. Laurie will serve as your lead client service partner, overseeing all projects we perform for the Port.



Jim Lanzarotta, CPA, Business Assurance Partner

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



Chris Kradjan, CPA, Northwest Consulting Division Partner

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



Kory Hoggan, Business Assurance Senior Manager

Kory is an audit senior manager in our Governmental Services Group. He specializes in audits of governmental entities and employee benefit plans. He will manage the financial statement audit.



Alison Sellers, Business Assurance Manager

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



Kevin Villanueva, IT Consulting Senior Manager

Kevin Villanueva is a Senior Manager with the Information Technology Consulting Group and leads the firm's information security and infrastructure practice. Kevin has over 14 years of experience in information technology with industry specialization in not-for-profit entities and healthcare. Kevin will serve as project manager for the Port's IT general controls testing procedures.

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

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

Sun Yoon, Business Assurance Senior: Sun has six years of public accounting experience, specializing in serving governmental and not-for-profit entities. Sun has conducted and supervised governmental financial statements audits and Federal Circular OMB A-133 audits of large complex entities. This is Sun's fifth year serving the Port. Sun will manage the audit of the Port's federal awards, as well as providing assistance in the conduct of the financial statement audit.

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

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

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

Tyler Reparuk, Business Assurance Staff: Tyler has two years of public accounting experience and will spend most of his time performing procedures related to the capital asset accounts. This is Tyler's second year serving the Port.

Queenie Tai, Business Assurance Staff: Queenie has two years of public accounting experience and will work on both the Passenger Facility Charge audit and the audit of federal awards. This is Queenie's second year serving the Port.

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

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

COMMUNICATIONS TO AUDIT COMMITTEE

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

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

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