

PORT OF SEATTLE

MEMORANDUM

DATE: July 8, 2010
TO: POS Audit Committee
FROM: Tom Barnard, Policy Analyst
SUBJECT: Suggested Changes to the Audit Committee and Audit Committee Charter

BACKGROUND

Internal Audit was initially established in 2002 within what is currently known as Accounting and Financial Reporting (AFR). In January 2008, the Internal Audit was reorganized, with a dual reporting responsibility to the Audit Committee and the Chief Executive Officer (CEO).

In 2008, the Audit Committee began a regular series of monthly meetings. It revised its charter to reflect an enlarged agenda. It also added a public member, Steve Miller, with extensive experience in auditing. That first year focused on establishing a regular schedule of audits, with an emphasis on internal departmental audits and lease and concession audits. A longer-range plan encompassing five years was also initiated. The Internal Audit Manager also hired three additional audit staff, nearly doubling her staff.

The Audit Committee's primary responsibility has been to review audit reports prepared by the Internal Audit Department. That department develops an Internal Audit annual work plan, with Audit projects selected based on mitigating financial, operational, reputation, compliance, and accountability risks.

Most internal audits have focused on 1) Internal Port Department controls and 2) Lease and Concession Agreement compliance. The Lease and Concession Audits are of major importance, as approximately 70% of Port's operating revenue is generated through the more than 400 Lease and Concession Agreements (LCAs). Results have been quite positive; to date, Internal Audit has cumulatively recovered over \$2 million from such audits. The audit recovery has also been steadily declining; better compliance on the part of the lessees clearly shows that those audits are achieving the intended impact. The Audit Committee also initiated a series of "report-backs" in 2009, which were designed to insure that recommended changes to internal departments by Internal Audit were taking place and achieving results.

The Audit Committee has also reviewed the annual Audits performed by Moss Adams, including the Comprehensive Annual Financial Review (CAFR), and two FAA-required audits, the Passenger Facility Charges Audit, and what is known as the "Single Audit," an audit that monitors the Port's compliance with the Federal Financial Assistance Programs in accordance with Federal OMB Circular A-133. The 2009 audits had no findings whatsoever, a significant achievement. It has also reviewed finding by the

State Auditor's Office (SAO) and TKW, an outside firm which conducted a limited performance audit in 2007.

CURRENT ISSUES

The Audit Committee is currently reviewing its Charter, with an eye towards insuring the Charter remains an accurate guide to its responsibilities. Some initial changes have been suggested, and passed on to the Audit Committee in preparation for its June meeting. That meeting did not have time to take up that agenda item, and it will be reviewed at the July meeting. In the meantime, there have been two suggestions put forward regarding future work. One is a recommendation by the Audit Manager Joyce Kirangi, in consultation with the Chair of the Audit Committee that an Information and Technology Auditor be added to the Internal Audit staff to augment its capabilities in that area. In addition, there has been internal discussion that the Audit Committee be tasked with additional powers and duties, and those be reflected in the next iteration of the Audit Charter. Specific decisions have not been taken in this regard, but a variety of suggestions have been advanced.

In making such recommendations, it is vitally important that the work of the Audit Committee reflect the overall strategic goals of the Port. That coordination is what will give the AC the ability to monitor the internal controls, organizational abilities and performance measures necessary to succeed in implementing those goals. At the current time, the Port is engaged in a goal-setting exercise, mainly through the aegis of the Century Agenda. Both the Commission and the Senior Executives are coordinating on the formation of goals and objectives at this time.

Beyond any mandates that arise from those objectives, some of the strategic considerations that touch on the work of the Audit Committee can be drawn from the current external and internal environment. These are:

- The Port's emergence from the most serious economic downturn since the 1930's. Though the Seaport Division is on track to have one of its best years, long-range revenue growth is not likely to match current growth rates. Passenger growth at the Airport is likely to rise slowly as well. This situation, combined with financial demands on the budget from the environmental and regional transportation arenas, make it important for Port operations to be as efficient and productive as possible.
- The transition from a phase of concentrated building of new infrastructure to a new phase of maintenance and updating of infrastructure already built. This indicates pressure on particular departments, such as Seaport Maintenance, but also on all departments to insure their expense budgets are sufficient to protect the infrastructure they already have.
- The assessment, refinement and improvement of the Port's internal departmental and procedural architecture, in response to the 2007 SAO audit recommendations and legislative directives. Some of this will probably be driven by the response to the new SAO performance audit, due to be released in August. Nonetheless, the Port is moving from a phase of setting up this architecture to one of assessing and measuring its performance and efficiency.

- The necessity to measure new initiatives arising from increased responsibilities of some Port departments. The clearest examples are the new Small Contractors Program and the Port Jobs Program, both from the Office of Social Responsibility (OSR).

SUGGESTED CHANGES

For the Internal Audit department and the Audit Committee to be able to assist in the Port's response to these challenges, certain capabilities need to be added to the Internal Audit Department and the Audit Committee that would enhance their joint oversight of Port operations. These capabilities would likely require increased staffing for the Internal Audit Department and increased responsibilities for the Audit Committee. Much of this capability falls under the general heading of performance auditing, which responds to several needs

- The ability to understand strategic risk, as opposed to an operational risk. For instance, understanding operational risk from inadequate revenue controls, though important, is entirely different from the strategic risk to the seaport of deferring maintenance that would result in deteriorating or aging infrastructure, causing cargo operations to leave the Port.
- The need to understand how well a Department performs in obtaining the maximum bang from their spending buck.
- The need to understand how well a Department is keeping its budget in line with its long-range strategic Division or Port-wide goals.
- The need to understand how well the Department is working in cooperation with other cross-divisional functions, like the Capital Development Division and the Central Procurement Department.

For respond to these types of issues, I would like to make the following recommendations. These recommendations are put forward to enhance and enlarge the authority of the Audit Committee, and to give it more a pro-active role in the Port's Audit function. Upon approval, the Audit Committee should codify these changes in the new version of the Audit Committee Charter.

- The Audit Committee should review its current long-range plan, and turn it into a formal document requiring authorization by the Audit Committee. It should contain a specific plan for achieving one-year goals and three-year goals.
- The Audit Committee should have authority to formally approve the Internal Audit Department work plan. Currently that plan is closely reviewed and suggestions for changes are made, but the final version is not formally approved.
- The Audit Committee should receive not just exit reports, which most audits are, but also expand its work to hear general briefings on Port departments and the work they do. These would be pre-audit briefings, where the Audit Committee could request specific information to

be included in the audits, or particular types of audits to be done for a given department or lease.

- The Audit Committee should request a briefing from the Executive, especially Chief of Staff Kurt Beckett to discuss the establishment of performance measures for the divisions, a task currently in his portfolio.
- The Audit Committee should seek formal input into the budgetary authorizations for the Internal Audit Department. This would increase the authority of the Committee over the Internal Audit function, without changing its dual reporting status.
- The Audit Committee should seek formal budget authorization to increase the staff of the Internal Audit Department to hire performance auditors.

The proposed changes are incorporated into the current suggested changes to the Audit Committee Charter. Changes are listed in red. Both the existing Charter and the version containing suggested changes will be sent. Discussion of this memo and the Charter can occur at the July 13, 2010 meeting.