



Assurance

**Presentation to audit and reporting committee of
Central Puget Sound Regional Transit Authority**

2016 Financial statement audit plan

December 15, 2016

kpmg.com



Overview of the audit plan

Audit team

KPMG's audit overview

Audit deliverables

Key transactions and events in 2016

Risk-based approach

Single audit

Audit timeline

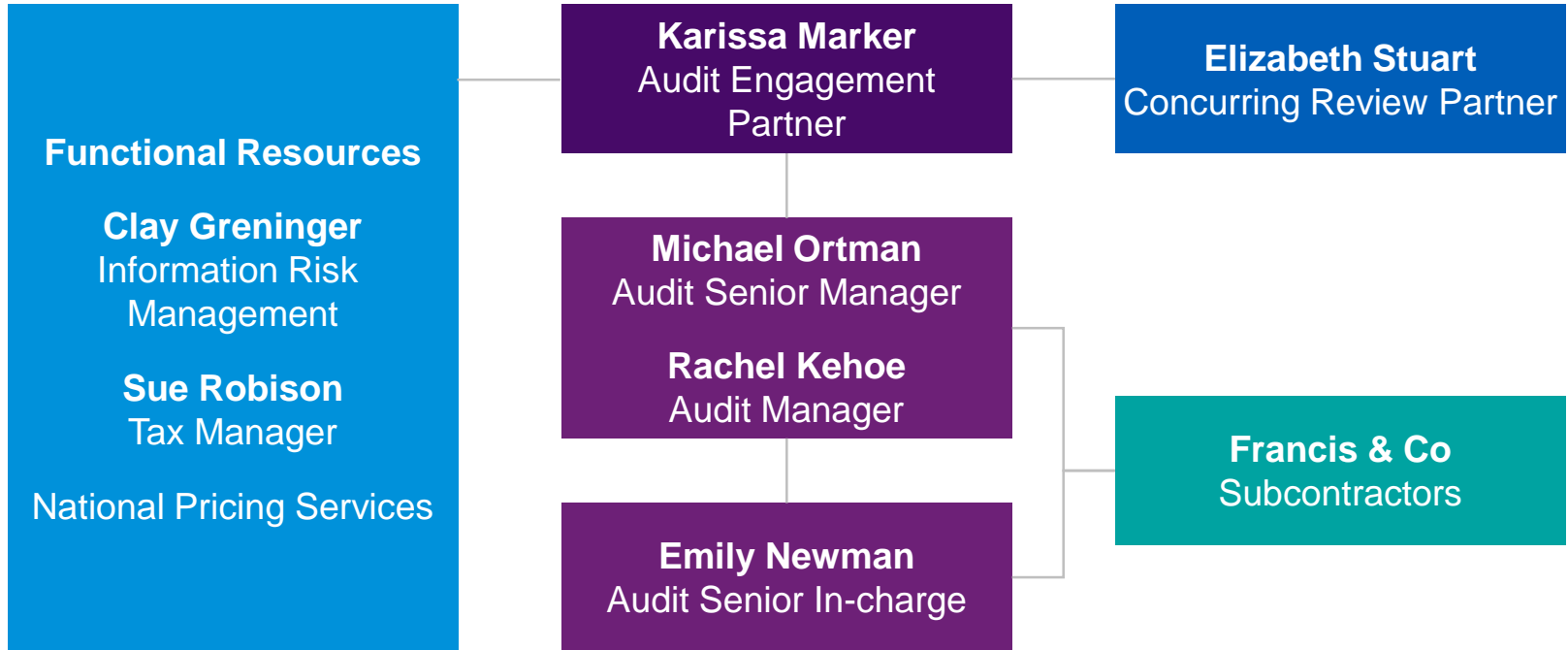
Appendix I: Overview of the audit process

**Appendix II: The single audit –
Compliance requirements**

**Appendix III: New and upcoming
accounting pronouncements**



Sound Transit Engagement Team



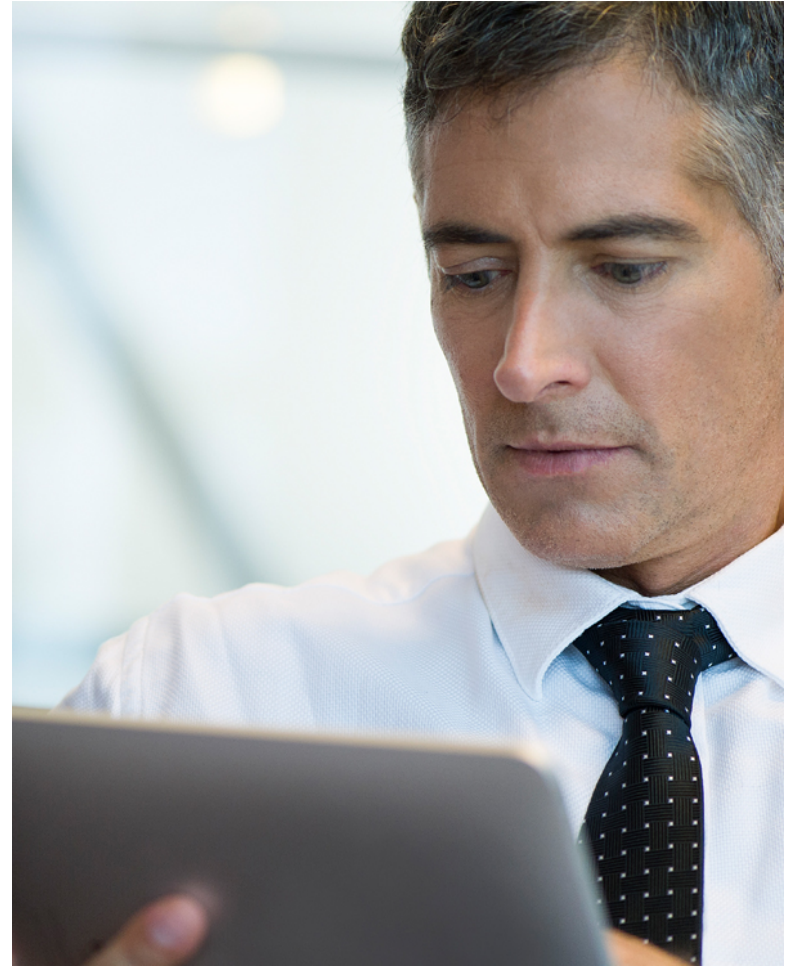
Objective of an audit

- The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with GAAP.
- An audit of financial statements is designed to provide reasonable, not absolute, assurance that the financial statements taken as a whole are free from material misstatement.
- Reasonable assurance relates to the accumulation of sufficient appropriate audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole.



Materiality

- Professional standards require that we exercise professional judgment when we consider audit risk and materiality both in planning the audit and designing audit procedures, and when evaluating the effect of misstatements.
- Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the item or error judged in the particular circumstances of its omission or misstatement.



Responsibilities of management and KPMG

Management responsibility

- Adopting sound accounting policies
- Establishing and maintaining internal control
- Fairly presenting the financial statements in conformity with generally accepted accounting principles

Board responsibility

- Oversight of the financial reporting process and internal controls over financial reporting
- Establishing and maintaining internal control
- Setting the proper tone and creating and maintaining a culture of honesty and high ethical standards

KPMG responsibility

- Conducting an audit in accordance with professional standards and complying with the Code of Professional Conduct adopted by the American Institute of Certified Public Accountants.
- Complying with the ethical standards of state CPA societies, state boards of accountancy, the SEC (or other regulators), and the PCAOB.
- Performing an audit with an attitude of professional skepticism.
- Complying with all communications requirements to the Audit and Reporting Committee.

Reports and letters to be issued

Sound transit reports

- Audit of financial statements as of and for the year ending December 31, 2016
- Federal single audit report as of and for the year ending December 31, 2016
- Agreed Upon Procedures for Subarea
- Agreed Upon Procedures for National Transit Database
- Management Letter (if applicable)
- Letter of Required Communications to Audit and Reporting Committee
- Engagement Letters
- Green Bonds

Other reports

- ORCA stand-alone audit report



Key transactions and events in 2016

As KPMG has been planning our audit procedures, ST management has identified the following events for which the engagement team will add focus:

- Capitalization of University Link and S. 200th (Angle Lake) Link Extension
- \$1.6 billion Master Credit Agreement with TIFIA
- E1 (ERP) system upgrade effective in December 2016
- New Human Resources/Payroll software implemented
- Purchase of 25 new buses to replace aging fleet
- Purchase of new land for East Link
- Green Bonds



Significant accounts, transactions, and estimates

Significant accounts and transactions

- Capital assets
- Revenue generation
- Investments and interest income
- Federal funding and compliance
- Transactions with other governments
- Long-term debt

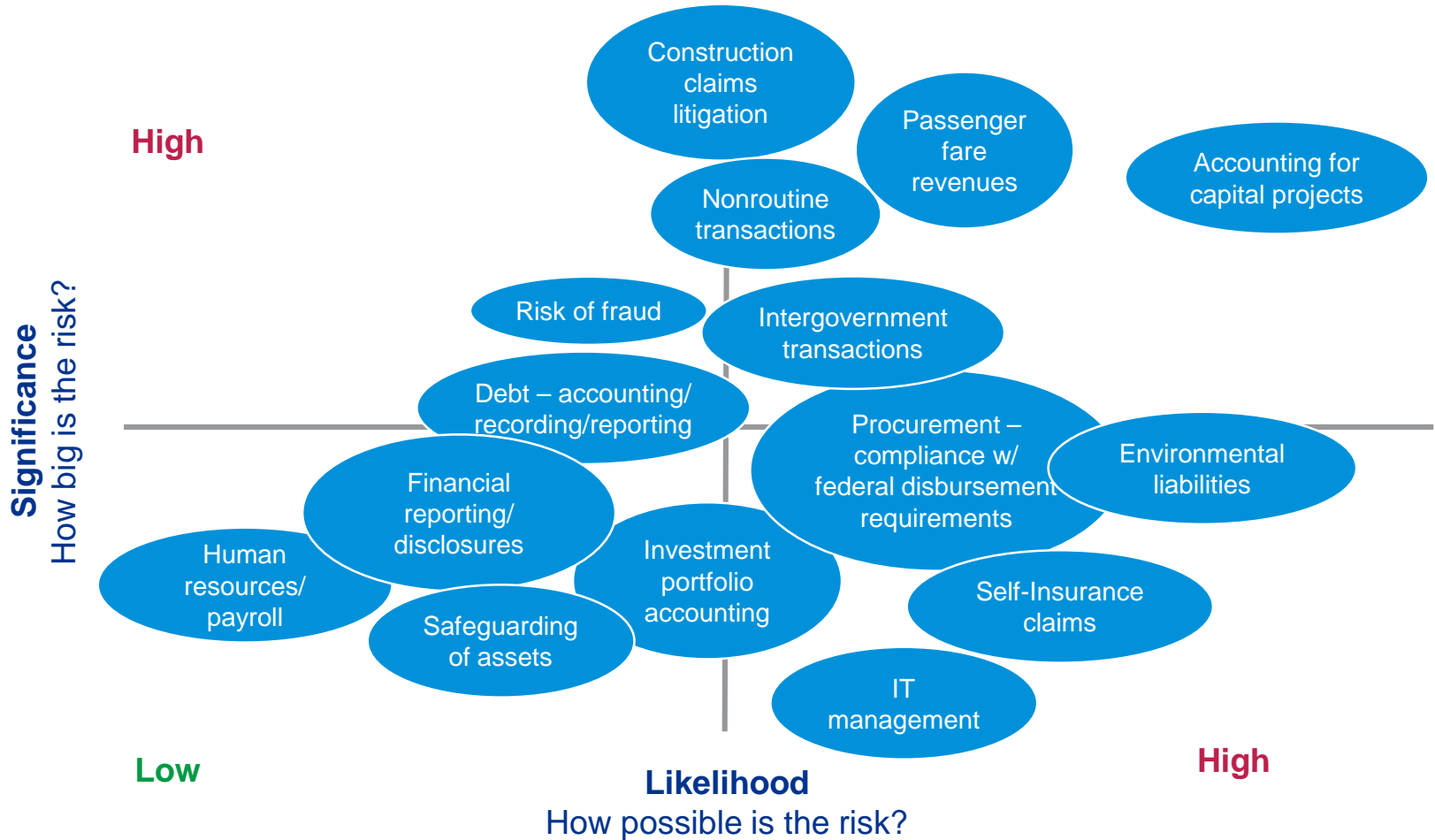
Significant estimates and disclosures

- Construction claim liability
- Valuation of investments
- Accounting for land swaps
- Overhead allocation
- Capturing and presenting expenses

Fraud risks—Some of what KPMG considers

Incentives/pressures	Opportunities (easiest to commit/hardest to detect)
<ul style="list-style-type: none"> — Political pressures — Third party pressures — Internal pressures — Communications to public — Financial interests 	<ul style="list-style-type: none"> — Identified financial statement or assertion level fraud risks — Account balances or classes of transactions — Particular operating segments — Related party — Significant unusual transactions — Ineffective controls or oversight
Attitudes/rationalizations	Knowledge of suspected or alleged fraud
<ul style="list-style-type: none"> — Integrity — Attitudes toward selection and implementation of accounting policies and practices — Attitudes toward internal control over financial reporting 	<ul style="list-style-type: none"> — Noncompliance with applicable standards — Identified management misconduct or override of controls — Disclosures related to applicable regulations — Reported suspected or alleged fraud or misconduct

Financial statement audit risk matrix



Trésingault

Purpose

- The Single Audit Act was enacted to reduce the audit burden on states, local governments, and not-for-profit organizations
- Set forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local governments, and non-profit organizations expending Federal awards

Requirements

- Non-Federal entities that expend \$750,000 or more in a fiscal year in Federal awards are required to have a Single Audit conducted
- The Uniform Guidance became effective December 26, 2014, and the audit requirements are effective for Sound Transit's 2016 Single Audit
- Single Audit reports are required to be filed with the Federal Clearinghouse the earlier of 9 months after the fiscal year-end or 30 days from receipt of the report

Audit objectives

- An audit of the entities financial statements and the reporting on the schedule of expenditures of federal awards in relation to those financial statements
- A compliance audit of federal awards expended during the fiscal year

Ad timeline

	Prior	Dec	Jan	Feb	Mar	Apr	May	June
Audit planning								
Client service team meeting								
Planning meeting with management								
Meeting with the Audit and Reporting Committee								
Interim procedures								
Review of key risks								
Process and control documentation and testwork								
Final audit procedures and draft reporting								
IT Fieldwork								
Final fieldwork								
Weekly status meetings								
Closing meeting								
Financial statements								
Reporting								
Meet with Audit and Reporting Committee to discuss financial statements and management recommendations								

Audit reporting committee

- The Auditor's Responsibility under Generally Accepted Auditing Standards
- The Planned Scope and Timing of the Audit
- Significant Accounting Policies and Unusual Transactions
- Management Judgments and Accounting Estimates
- Audit Adjustments and Uncorrected Misstatements
- Disagreements with Management
- Difficulties Encountered in Performing the Audit
- Deficiencies in Internal Controls





Appendix I Overview of the audit process

Appendix II The single audit – Compliance requirements

Appendix III New and upcoming accounting pronouncements

Statement of financial position

Statement of financial position		
Financial statement caption	Audit consideration	Potential audit procedures
Cash and Investments	<ul style="list-style-type: none"> – Existence and accuracy of cash and investments – Valuation of investments 	<ul style="list-style-type: none"> – Test account reconciliations – Confirm selected balances – Specific testing of investment details by KPMG valuation specialist – Review compliance with investment policies – Test accuracy of disclosures, including proper classification between restricted and unrestricted balances
Receivables	<ul style="list-style-type: none"> – Proper recording of revenues and collections – Accuracy of account balances – Collectability – Valuation 	<ul style="list-style-type: none"> – Review A/R to general ledger reconciliation – Substantiation of A/R – Confirmation of tax revenues and receipt to date. – Review intergovernmental receivables and transactions

Statement of financial position (cont.)

Statement of financial position		
Financial statement caption	Audit consideration	Potential audit procedures
Capital Assets	<ul style="list-style-type: none"> — Proper capitalization of assets — Proper classification — Appropriate depreciation/ amortization — Potential impairment of capital assets — Safeguarding of Assets 	<ul style="list-style-type: none"> — Review rollforward of property accounts — Test on a sample basis additions and retirements to support and review assigned lives for reasonableness. — Test allocation of improvements related to the Rail Access Rights — Test significant and/or unusual transactions — Review and recalculate capitalized interest and overhead allocation — Review for reasonableness the accuracy of non ST owned assets — Obtain and review internal and external publications ensuring consistency with accounting for projects. — Analysis for impairments — Hold meetings with management throughout the Agency.

Statement of financial position (cont.)

Statement of financial position		
Financial statement caption	Audit consideration	Potential audit procedures
Other Assets	<ul style="list-style-type: none"> – Realizability – Proper classification 	<ul style="list-style-type: none"> – Test reconciliation of accounts – Test significant additions to supporting documentation
Accounts Payable and Accrued Liabilities	<ul style="list-style-type: none"> – Recognition of transaction in proper accounting period – Accuracy of amounts recorded and assessment of “reasonableness” of accruals in judgmental areas or areas subject to estimates 	<ul style="list-style-type: none"> – Test reconciliation of AP subledger to the general ledger – Perform review of subsequent disbursements – Test and review reasonableness of year-end accruals – Perform inquiries within In-house General Counsel and external counsel as necessary – Engage KPMG-Actuary to perform review procedures over self-insurance

Statement of financial position (cont.)

Statement of financial position		
Financial statement caption	Audit consideration	Potential audit procedures
Long-term Debt	<ul style="list-style-type: none"> — Proper classification — Compliance with financial covenants 	<ul style="list-style-type: none"> — Review rollforward of debt balances — Recalculate required reserves to ensure compliance with covenants — Confirm balances — Test disclosures and classifications
Net Position	<ul style="list-style-type: none"> — Proper classification and accurate reflection of activities — Recognition of assets released from restriction 	<ul style="list-style-type: none"> — Perform analytical procedures to determine the reasonableness of the classifications within net position. — Agree detail to other areas of testwork

Statement of revenues, expenses, and changes in net position

Statement of revenues, expenses and changes in net position		
Financial statement caption	Audit consideration	Potential audit procedures
Passenger Revenue	<ul style="list-style-type: none"> — Proper revenue recognition 	<ul style="list-style-type: none"> — Overall predictive testing of routine revenues and ensure reasonable based on procedures performed over NTD. — Performing control testwork over the allocation of funds performed by ST as Fiscal Agent of ORCA.
Grant Revenues	<ul style="list-style-type: none"> — Proper revenue recognition — Proper classification 	<ul style="list-style-type: none"> — Agree grant revenue to amount reported in the Schedule of Expenditures of Federal Awards and audit work as part of the compliance audit — Agree to cash receipts and other supporting documentation
Other Operating Revenues	<ul style="list-style-type: none"> — Proper revenue recognition 	<ul style="list-style-type: none"> — Variation analysis and detail testing as determined necessary

Statement of revenues, expenses, and changes in net position (cont.)

Statement of revenues, expenses and changes in net position		
Financial statement caption	Audit consideration	Potential audit procedures
Operating Expenses <ul style="list-style-type: none"> ■ Salaries and benefits ■ Operations and Maintenance ■ Supplies ■ Depreciation 	<ul style="list-style-type: none"> — Recognized in proper accounting period — Accuracy of amounts recorded — Cost allocation process 	<ul style="list-style-type: none"> — Develop understanding of processes and key controls — Variation analysis including analysis of key metrics — Reasonableness/predictive testing — Compliance testing of certain cash disbursements controls — Substantive test of detail on a sampling basis of recorded expenses — Ensure costs are being allocated according to the cost allocation plan
Nonoperating Revenues	<ul style="list-style-type: none"> — Proper recognition and presentation 	<ul style="list-style-type: none"> — Variation analysis



Federal grants and contracts		
Assertion	Audit consideration	Potential audit procedures
Financial statements are presented fairly	<ul style="list-style-type: none"> — Audited financial statements 	<ul style="list-style-type: none"> — Complete audit of financial statements in accordance with Generally Accepted Accounting Standards (GAAS) and Generally Accepted Government Auditing Standards (GAGAS)
Schedule of expenditures of federal awards is accurate	<ul style="list-style-type: none"> — Proper reporting of federal awards and funding — Recognition of grant revenue and expenditures 	<ul style="list-style-type: none"> — Agree grant reporting of expenditures and reimbursement to schedule of federal expenditures — Agree schedule of federal expenditures to audited financial statements

Sageant (cont.)

Federal grants and contracts		
Assertion	Audit consideration	Potential audit procedures
Evaluate and test internal controls over major programs	<ul style="list-style-type: none"> — Allowability of expenditures — Proper authorization and review of expenditures — Controls over grant reporting 	<ul style="list-style-type: none"> — Review and documentation of the grant application and monitoring process and controls — Test expenditures and payroll for allowability, classification and authorization
Verify compliance with laws, regulations and provisions of federal contracts and grants	<ul style="list-style-type: none"> — Compliance with general requirements — Specific grant and contract requirements 	<ul style="list-style-type: none"> — Review applicable policies for compliance areas — Test major programs for compliance with specific requirements — Review sub recipient monitoring processes, if any sub recipients

Compliance requirements

The list below represents the 13 standard compliance requirements for single audits and their historical applicability to ST. We will evaluate their application based on the nature and use of the grant.

Requirement	Applicable?	Direct and material?	Not DM?
Activities allowed or unallowed	✓	✓	
Allowable costs/cost principles	✓	✓	
Cash management	✓	✓	
Eligibility			
Equipment and real property management	✓	✓	
Matching, level of effort, earmarking	✓	✓	
Period of performance	✓	✓	
Procurement, suspension and debarment	✓	✓	
Program income	✓		✓
Real property acquisition and relocation	✓	✓	
Reporting	✓	✓	
Subrecipient monitoring	✓		✓
Special tests and provisions	✓	✓	

~~GAAP~~ *ASC 820, Fair Value Measurements and Application*

- Provides guidance for applying fair value measurements to certain investments, and disclosures related to all fair value measurements. This statement establishes a three-level hierarchy of inputs to valuation techniques used to measure fair value, and requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques.
- Effective for periods beginning after June 15, 2015 (ST year ended December 31, 2016)

KPMG's Audit Committee Institute (ACI)

Upcoming events

- Audit Committee Quarterly Webcast Series
 - A quarterly Webcast providing updates and insights into issues affecting audit committee/board oversight—from key accounting and regulatory changes to developments in risk oversight.

Resources

- Audit Committee Insights – U.S. and International editions (biweekly electronic publications): www.kpmginsights.com
- ACI Web site: www.auditcommitteeinstitute.com
- ACI mailbox: auditcommittee@kpmg.com
- ACI hotline: 1-877-KPMG-ACI

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Questions



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