



SAN DIEGO COUNTY
REGIONAL AIRPORT AUTHORITY
AUDIT COMMITTEE

Item No.
2

Meeting Date: **MAY 7, 2012**

Subject:

Required Communications from the External Auditor to the Audit Committee on the Fiscal Year Ended June 30, 2012, Financial and Compliance Audit

Recommendation:

Staff recommends that the Audit Committee forward this item to the Board for information.

Background/Justification:

As outlined in the Agreement between the San Diego County Regional Airport Authority and the external auditor, McGladrey & Pullen, LLP, an audit of the Authority's financial statements shall be performed following generally accepted auditing principles and government auditing standards, to complete an independent external audit in conjunction with the an assessment of the Authority's internal controls for fiscal years 2009, 2010, and 2011.

On April 12, 2012, the Board executed a first amendment to the Agreement with McGladrey & Pullen, LLP, exercising both one-year options to extend the term of the Agreement to May 2014.

The Charter of the Audit Committee requires that the external auditor's plan for conducting the audit of the Authority's financial statements be reviewed and approved by the Audit Committee. The Charter requires reviews of the external auditor's annual report on independence, a report on its quality control program and peer review, and a review of the external auditor's audit fees.

A letter to the Audit Committee from McGladrey & Pullen communicating matters pertaining to the Fiscal Year Ended June 30, 2012, Financial and Compliance Audit is provided in Attachment A, and will be formally presented by McGladrey & Pullen at the May 7, 2012, Audit Committee Meeting.

Fiscal Impact:

None

Authority Strategies:

This item supports one or more of the Authority Strategies, as follows:

☐ Community Strategy ☐ Customer Strategy ☐ Employee Strategy ☒ Financial Strategy ☒ Operations Strategy

Environmental Review:

1. This Board action, as an administrative action, is not a project that would have a significant effect on the environment as defined by the California Environmental Quality Act (CEQA), as amended. 14 Cal. Code Regs. §15378. This Board action is not a "project" subject to CEQA, Cal. Pub. Res. Code §21065.
2. This Board action is not a "development" as defined by the California Coastal Act. Cal. Pub. Res. Code §30106.

Equal Opportunity Program:

Not applicable

Prepared by:

MARK A. BURCHYETT
CHIEF AUDITOR

April 20, 2012

To the Members of the Audit Committee
San Diego County Regional Airport Authority
San Diego, California

This letter is intended to communicate certain matters related to the planned scope and timing of our audit of the San Diego County Regional Airport Authority's (the Airport Authority) financial statements and compliance as of and for the year ending June 30, 2012.

Communication

Effective two-way communication between our Firm and the Audit Committee is important to understanding matters related to the audit and in developing a constructive working relationship.

Your insights may assist us in understanding the Airport Authority and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events. We will discuss with you your oversight of the effectiveness of internal control and any areas where you request additional procedures to be undertaken. We expect that you will timely communicate with us any matters you consider relevant to the audit. Such matters might include strategic decisions that may significantly affect the nature, timing, and extent of audit procedures, your suspicion or detection of fraud or abuse, or any concerns you may have about the integrity or competence of senior management.

We will timely communicate to you any fraud involving senior management and other fraud that causes a material misstatement of the financial statements, illegal acts, instances of noncompliance, or abuse that come to our attention (unless they are clearly inconsequential), and disagreements with management and other serious difficulties encountered in performing the audit. We also will communicate to you and to management any significant deficiencies or material weaknesses in internal control that become known to us during the course of the audit. Other matters arising from the audit that are, in our professional judgment, significant and relevant to you in your oversight of the financial reporting process will be communicated to you in writing after the audit.

Independence

Our independence policies and procedures are designed to provide reasonable assurance that our firm and its personnel comply with applicable professional independence standards. Our policies address financial interests, business and family relationships, and non-audit services that may be thought to bear on independence. For example, without our permission no partner or professional employee of McGladrey & Pullen, LLP is permitted to have any direct financial interest or a material indirect financial interest in a client or any affiliates of a client. Also, if an immediate family member or close relative of a partner or professional employee is employed by a client in a key position, the incident must be reported and resolved in accordance with Firm policy. In addition, our policies restrict certain non-audit services that may be provided by McGladrey & Pullen, LLP and require audit clients to accept certain responsibilities in connection with the provision of permitted non-attest services.

The Audit Planning Process

Our audit approach places a strong emphasis on obtaining an understanding of how the Airport Authority functions. This enables us to identify key audit components and tailor our procedures to the unique aspects of your operations. The development of a specific audit plan will begin by meeting with you and with management to obtain an understanding of business objectives, strategies, risks, and performance.

We will obtain an understanding of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts and grant agreements to assess the impact of internal control on determining the nature, timing, and extent of audit procedures, and we will establish an overall materiality limit for audit purposes. We will conduct formal discussions among engagement team members to consider how and where your financial statements might be susceptible to material misstatement due to fraud or error or to instances of noncompliance.

We will use this knowledge and understanding, together with other factors, to first assess the risk that errors or fraud may cause a material misstatement at the financial statement level. The assessment of the risks of material misstatement at the financial statement level provides us with parameters within which to design the audit procedures for specific account balances and classes of transactions. Our risk assessment process at the account-balance or class-of-transactions level consists of:

- An assessment of inherent risk (the susceptibility of an assertion relating to an account balance or class of transactions to a material misstatement, assuming there are no related controls); and
- An evaluation of the design effectiveness of internal control over financial reporting and our assessment of control risk (the risk that a material misstatement could occur in an assertion and not be prevented or detected on a timely basis by the entity's internal control).

Similar assessments will also be made relative to compliance with laws, regulations, and provisions of contracts and grant agreements.

We will then determine the nature, timing, and extent of tests of controls and substantive procedures necessary given the risks identified and the controls as we understand them.

The Concept of Materiality in Planning and Executing the Audit

In planning the audit, the materiality limit is viewed as the maximum aggregate amount, which if detected and not corrected, would cause us to modify our opinion on the financial statements. The materiality limit is an allowance not only for misstatements that will be detected and not corrected but also for misstatements that may not be detected by the audit. Our assessment of materiality throughout the audit will be based on both quantitative and qualitative considerations. Because of the interaction of quantitative and qualitative considerations, misstatements of a relatively small amount could have a material effect on the current financial statements as well as financial statements of future periods. At the end of the audit, we will inform you of all individual unrecorded misstatements aggregated by us in connection with our evaluation of our audit test results.

Our Approach to Internal Control and Compliance Relevant to the Audit

Our audit of the financial statements will include obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify significant deficiencies or

material weaknesses. Our review and understanding of the Airport Authority's internal control is not undertaken for the purpose of expressing an opinion on the effectiveness of internal control.

We will issue reports on internal control related to the financial statements and major programs. These reports describe the scope of testing of internal control and the results of our tests of internal controls. Our reports on internal control will include any significant deficiencies and material weaknesses in the system, of which we become aware as a result of obtaining an understanding of internal control and performing tests of internal control consistent with the requirements of the *Government Auditing Standards* issued by the Comptroller General of the United States, the Single Audit Act, and the U.S. Office of Management and Budget, (OMB) Circular No. A-133.

We will issue reports on compliance with laws, regulations, and the provisions of contracts or grant agreements. We will report on any noncompliance which could have a material effect on the financial statements and any noncompliance which could have a direct and material effect on each major program. Our reports on compliance will address material errors, fraud, abuse, violations of compliance requirements, and other responsibilities imposed by state and federal statutes and regulations and assumed contracts; and any state or federal grant, entitlement or loan program questioned costs of which we become aware, consistent with the requirements of the standards and circular identified above.

Using the Work of Internal Auditors

As part of our understanding of internal control, we will obtain and document an understanding of your internal audit function. We will read relevant internal audit reports issued during the year to determine whether such reports indicate a source of potential error or fraud that would require a response when designing our audit procedures. Because internal auditors are employees, they are not independent and their work can never be substituted for the work of the external auditor. We may, however, alter the nature, timing, and extent of our audit procedures, based upon the results of the internal auditor's work or use them to provide direct assistance to us during the performance of our audit.

Timing of the Audit

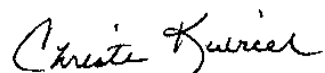
We have scheduled preliminary audit field work for May 21-31, 2012 with final field work commencing the week of August 27, 2012. Management's adherence to its closing schedule and timely completion of information used by us in performance of the audit is essential to timely completion of the audit.

Closing

We will be pleased to respond to any questions you have about the foregoing. We appreciate the opportunity to be of service to the Airport Authority.

This communication is intended solely for the information and use of the Audit Committee, the Board of Directors, and management, and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP



Christie Kubicek, Partner

**San Diego County Regional Airport Authority
Communications with Audit Committee
Financial & Compliance Audit for the Year Ending
June 30, 2012**

**Presented By:
Christie Kubicek, Partner
Peter George, Director
McGladrey & Pullen, LLP
May 7, 2012**



Agenda

- Engagement Objectives
- Audit Planning Process
- Audit Focus Areas
- Required Deliverables
- Communications with Audit Committee
- Questions and Answers

Engagement Objectives

- Perform an audit of the Airport Authority's basic financial statements as of and for the year ending June 30, 2012.
- The objective of an audit of financial statements is to express an opinion that the financial statements are in accordance with GAAP.
- The audit will be performed in accordance with auditing standards generally accepted in the United States and *Government Auditing Standards*.
- Those standards require that we plan and perform the audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement whether caused by error or fraud.

Audit Planning Process

- Overview of Audit Approach / Scope of the Audit
- Risk Assessment
- Understand and Test Internal Controls to Plan the Audit
- Use of Internal Auditors
- Identification of Focus Areas
- Detailed Audit Procedures
- Communications

Audit Focus Areas

- Cash and Investments
- Receivable, Tenant Leases, Grants and Notes, Passenger Facility Charge (PFC)
- Capital Assets – Construction in Process
- Debt issues and related accounts
- Accounts Payable and Accrued Liabilities
- Pension Plan and Other Post Employment Benefits (OPEB's)
- Compliance Testing – PFC, CFC & Single Audit
- Proper Revenue Recognition & Expense Cut-offs

Required Deliverables

- Audit Opinion on Airport Authority's Basic Financial Statements
- Audit Opinion on Airport Authority's CAFR
- Single Audit (Compliance) Report
- Passenger Facility Charge Compliance Report
- Customer Facility Charge Compliance Report
- Communication of Internal Control Related Matters Identified in an Audit
- Required Communications with the Audit Committee (Summary of Audit Results)

The Auditor's Communication with those Charged with Governance

- Expands current communications to include:
 - Engagement objectives
 - Two-way communication
 - Independence
 - Audit planning process
 - The concept of materiality in planning and executing the audit
 - Audit approach
 - Use of internal auditors
 - Timing of the audit procedures

Communications with Audit Committee Members

- During Planning, Fieldwork and Presentation of Opinions
- Strategic Decisions Made That May Affect the Audit
- Business Risks Facing the Airport Authority
- Revenue/Funding Risks
- Fraud Risks
- Other Concerns

Questions?

Thank you