Internal Audit Report

Lease and Concession Audit

Concessions International, LLC

January 1, 2009 through December 31, 2011

Issue Date: February 5, 2013

Report No. 2013-02

Table of Contents

Transmittal Letter

Audit Committee
Port of Seattle
Seattle, Washington

We have completed an audit of Concessions International, LLC for the period from January 1, 2009 through December 31, 2011.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We extend our appreciation to the management and staff of Aviation Business Development and Accounting and Financial Reporting for their assistance and cooperation during the audit.

Kirangi

Joyce Kirangi, CPA, CGMA
Director, Internal Audit

Executive Summary

Audit Scope and Objective The purpose of the audit was to determine whether:

1. The reported concession fees were complete, properly calculated, and remitted timely to the Port.
2. The Port and the lessee complied with significant provisions of the Lease and Concession Agreement.

We examined the books and records of Concessions International for a period of thirty-six months from January 1, 2009, through December 31, 2011.

Aviation Business Development, in conjunction with Accounting and Financial Reporting, has the primary responsibility for administering and monitoring the agreement to ensure compliance with agreed-upon terms.

Agreement Terms The agreement provides a Minimum Annual Guarantee (MAG) or percentage fees on their gross receipts generated at the airport. The concession percentage fees range from 10% on branded food and beverage up to 26.5% on souvenirs.

The percentage fee is due on or before the 15th of each month for the preceding month. For untimely payments, the agreement provides for a one-time late fee of 5% of the overdue amount and interest to be accrued at the rate of 18% per-year from the due date until paid.

During the audit period, the agreement generated approximately $1 million annually in concession revenues for the Port.

Audit Result Summary The concession reported to the Port was materially complete, properly calculated, and timely paid. Additionally, we noted no significant compliance exceptions with the Lease and Concession Agreement.

Background

Concessions International, LLC (CI) has been in business since 1979 and is currently headquartered in Atlanta, Georgia. It is a family and minority-owned company with operations in eight major U.S. cities, including Seattle.

Under the terms of the agreement with the Port, the lessee agreed to pay a Minimum Annual Guarantee (MAG) or percentage fees on their gross receipts generated at the airport. The percentage concession fees range from 10% on branded food and beverage up to 26.5% on souvenirs.

For the audit period, the lessee operated and managed the following stores and subtenants:

1. Stores:
   a. Three Seattle's Best Coffee.
   b. Two Runaway Grill Delis
      - Concourse D location discontinued operations in the fourth quarter of 2010
   c. Kobo / Udon
2. Subtenants:
   a. Burger King – discontinued operations in the third quarter of 2009
   b. BigFoot Food and Spirits

The percentage fee is due on or before the 15th of each month for the preceding month. For untimely payments, the agreement provides for a one-time late fee of 5% of the overdue amount and interest to be accrued at the rate of 18% per year from the due date until paid.

Below are the revenue highlights for the last four calendar years:

	2009	2010	2011	2012
Food & Beverage	$964,664	$1,083,771	$1,084,950	$1,115,790
Liquor	$139,122	$ 164,146	$200,633	$193,301

Data source: PeopleSoft, as of 1/25/2013

Audit Scope and Methodology

We conducted the audit to determine whether the lessee was in compliance with the lease agreement terms including, but not limited to, proper concession payments. We utilized a risk-based audit approach from planning to test sampling. We gathered information through document requests, interviews, observation and analytical reviews in order to obtain a complete understanding of the financial requirements of the agreement. We applied additional detailed audit procedures to areas with the highest likelihood of significant negative impact as follows:

a) **Timely Payment**

We reviewed all payment records for the audit period to determine whether the lessee made timely payments as stipulated in the agreement.

b) **Annual Report**

We reviewed annual reports to determine compliance with the timely and complete submission of the report.

c) **Minimum Annual Guarantee (MAG)**

We re-calculated the MAG amount for each agreement year during the audit period, as well as applicable MAG reliefs. The agreement provides a relief in the monthly MAG amount, triggered by a set percentage reduction in enplanements.

d) **Concession Revenue**

To determine whether the lessee completely reported all concession revenues, we performed the following:

- Reconciled the reported concession to the lessee's accounting records to ensure consistency and completeness.
- Reconciled the reported concession to revenues reported to third parties, including Washington State on its excise tax returns and a franchisor, to ensure consistency and reasonableness.
- Conducted a walk-through of retail locations to ensure that the reported concession and its components reflect operations.
- Conducted a test of Branded Food and Beverage definition, which has a lower concession rate.
- Conducted a test of point-of-sales data for nine days with highest discounts. The batches were reconciled to bank statements to ensure complete and accurate reporting of concession revenues and discounts.
- Conducted trend analyses of concession revenue to ensure overall reasonableness of the reported concession.

Conclusion

The concession reported to the Port was materially complete, properly calculated, and timely paid. Additionally, we noted no significant compliance exceptions with the Lease and Concession Agreement.