Port of Seattle

Internal Audit Report

Lease & Concession Audit

Seattle Restaurant Associates

Food and Beverage Agreement (#439)

January 1, 2009 – December 31, 2011

Issue Date: October 1, 2013
Report No. 2013-13

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Transmittal Letter

Audit Committee
Port of Seattle
Seattle, Washington

We have completed an audit of the Seattle Restaurant Associates (RSA) Lease and Concession Agreement. We reviewed information relating to a three-year period from January 1, 2009 – December 31, 2011.

We conducted the audit in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. 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 Aviation Business Development Office and Accounting and Financial Reporting staff for their assistance and cooperation during the audit.

Kirangi

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Responsible Management Team:

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Executive Summary

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

1. The reported concession is complete, properly calculated, and remitted timely.
2. The lessee complied with significant provisions of the lease and concession agreements.

The scope of our audit covered the period from January 1, 2009 through December 31, 2011.

Background The agreement provides a Minimum Annual Guarantee, or fees based on a percentage of Seattle Restaurant Associates' gross receipts. These percentage fees range from 14% on food and beverage sales and up to 27% 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 an accrued interest charge of 18% per-year from the due date until paid.

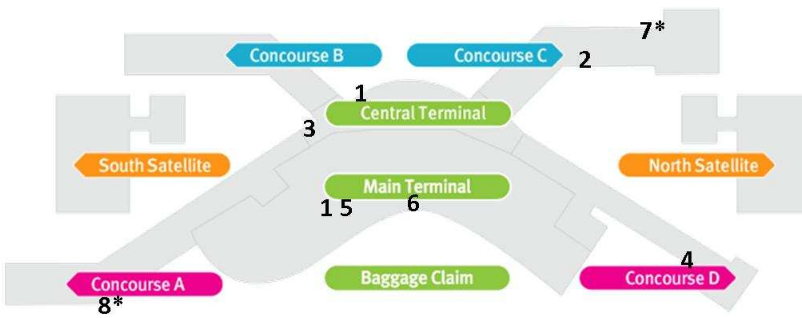
Audit Result Summary Seattle Restaurant Associates (SRA) materially complied with the terms of the Lease and Concession agreement, with two exceptions: we identified a minor revenue discrepancy for one of the subtenants, and SRA did not provide requested documents in a reasonable time frame as required by the agreement. See Schedule of Findings and Recommendations in this audit report.

Background

Seattle Restaurant Associates (SRA) is a joint venture between HMS Host and Uwajimaya. HMS Host is the agreement's managing partner. SRA operates or oversees ten unique food and beverage concessions at Seattle-Tacoma International Airport (STIA), with a focus on regional brands and nationally recognized chains. These concessions include a mixture of both full and self-service eateries. SRA currently has two subleases with certified Disadvantaged Business Enterprises as follows: The Waji's at Sea-Tac is operated by Concourse Concessions, LLC and the Mountain Room Bar is operated by SeaTac Bar Group.

Seattle Restaurant Associates' Department Locations

Seattle-Tacoma International Terminal - As of December 31, 2011



Names and Locations of Seattle Restaurant Associate's Departments			
1	Kathy Casey Dish D'Lish Food to Go (2 locations)	5	Pilot House Lounge
2	Wolfgang Puck Express & Wolfgang Puck Grab n' Go	6	Vintage Washington Wine Bar
3	Seattle Taproom	7*	Waji's at Sea-Tac
4	Chili's Too & Chili's Margarita Bar	8*	Mountain Room Bar

Note: ID's with an asterisk (*) indicate a department operated by a SRA Sub-Tenant

Under the lease and concession agreement, SRA self-reports its monthly gross receipts for all of its operations, including those run by the subtenants. The agreement defines gross receipts as all sales, less tips to employees, refunds for unsatisfactory services, complimentary meals and discounts and all applicable sales taxes levied on customers.

The agreement calls for different percentage fees for separate sales categories. The table below shows the gross receipts by category, along with the categories' respective rates:

Seattle Restaurant Associates Gross Receipts by Concessionable Category[1]
January 1, 2009 – December 31, 2011

Concession Category	Rate	2009	2010	2011
Food & Beverage Sales	14%	$4,521,394	$4,306,984	$4,552,635
Branded Food & Beverage Sales	12%	6,031,557	6,034,610	6,346,805
Alcoholic Beverage Sales	18%	3,465,210	3,337,565	3,557,223
Souvenir Merchandise	27%	0	0	0
Advertising Revenue	15%	0	0	0
TOTAL		**$14,018,161**	**$13,679,159**	**$14,456,663**

Data Source: Seattle Restaurant Associates PeopleSoft Financials, CPA-Audited Reports for 2009-2011.
Data Notes: [1]Gross Sales Receipts are rounded to the nearest dollar.

Audit Scope and Methodology

We reviewed information for the period from January 1, 2009 - December 31, 2011. We utilized a risk-based audit approach from planning to testing. We gathered information through research, interviews, observations and analytical reviews, in order to obtain a complete understanding of the Seattle Restaurant Associates lease and concession agreement.

We applied additional detailed audit procedures to areas with the highest likelihood of significant negative impact as follows:

1. Completeness of Reported Revenue

   We reviewed lessee financial records including the lessee's point of sale data, general ledger, and bank records, along with the revenue reported to the Port. We selected one week of sales from the months of February and August in 2009, 2010, and 2011 for a total of six weeks. The testing period involved four SRA-operated food and beverage locations and two of its subtenant-operated locations. We traced the revenue from the point-of-sale to the general ledger and deposit records, and ultimately to the revenues reported to the Port.

2. Timely Submission of Rent and Concession Payments

   We reviewed the Port's records to determine whether the rent and concession payments were received on time. In the event that payments were received later than the ten-day grace period identified in the lease and concession agreements, we calculated the expected interest and finance charge, if it had not been assessed.

3. Compliance with Branded Food Reporting Requirements

   We identified the requirements for reporting concession at the reduced "Branded Food & Beverage" (Branded Food) concession rate. We reviewed franchise agreements and lessee documentation of royalty payments to determine whether the locations reporting Branded Food during the audit period met the criteria for the Branded Food rate.

4. Compliance with Insurance Requirements

   We identified the insurance coverage required by the food and beverage agreement for the audit period and determined whether the lessee had obtained sufficient coverage and submitted evidence to the Port in accordance with the agreement.

5. Compliance with Letter of Credit Requirements

   We identified the letter of credit amounts required by the food and beverage agreement for the audit period and determined whether the lessee had obtained the appropriate letter of credit and submitted evidence to the Port in accordance with the agreement.

6. Compliance with Annual Reporting Requirements

   We identified the annual reports required by the food and beverage agreement for the audit period and determined whether the lessee had submitted the reports to the Port in accordance with the agreement.

7. Compliance with Disadvantaged Business Enterprise Requirements

   We identified the disadvantaged business enterprise requirements for the food and beverage agreement for the audit period and determined whether the lessee had submitted the required information to the Port in accordance with the agreement.

Conclusion

Seattle Restaurant Associates (SRA) materially complied with the terms of the Lease and Concession agreement, with two exceptions: we identified a minor revenue discrepancy for one of the subtenants, and SRA did not provide requested documents in a reasonable time frame as required by the agreement. See Schedule of Findings and Recommendations in this audit report.

Schedule of Findings and Recommendations

1. SRA DID NOT PROVIDE ADEQUATE DOCUMENTATION TO SUPPORT GROSS SALES, AS REQUIRED BY THE AGREEMENT

Section 1.11 of the food and beverage lease agreement states:

> *"Gross Receipts" shall mean the aggregate gross amount of revenue derived from all sales of food, beverage and all other merchandise of any type or kind transacted…*

The agreement excludes certain items from gross receipts, such as tips paid to employees, refunds, complimentary meals, taxes, etc.

Our initial analysis of the lessee's financial records determined that the gross receipts for SeaTac Bar Group were underreported to the Port. SeaTac Bar Group is one of two subtenants operating under this agreement. The lessee-provided sales reports for the three weeks selected for detailed testing did not agree with the daily bank deposits. At first, the lessee-provided reports, data, and explanations did not account for the variance. Upon repeated requests for further information, the lessee provided additional documentation of the difference for the entire audit period and asserted that they incorrectly recorded upcharges for alcoholic beverages, which caused the variances. This assertion could not be substantiated because of lack of detailed sales data.

Point-of-sale data (such as cash register tapes) or similar transaction level information would have explained the variance. However, the lessee could not provide such information because the subtenant did not maintain such record or information.

Section 7 of the lease agreement states:

> *Lessee shall retain all accounting records, including cash register tapes and guest checks, for not less than three (3) years after the close of the applicable Agreement Year or until the close of any ongoing audit.*

We identified a difference of $6,244 between the reported and collected amounts for the audit period. This resulted in an additional concession of $1,102. After applicable late charges and interest are applied, a total of $1,703 is owed to the Port.

We realize that the amount questioned above is small relative to the total concession paid to the Port. However, the initial lack of cooperation from the subtenant, continuing challenges with data requests, and the lack of detailed accounting records to support the sales, raises questions as to the validity and/or accuracy of the financial data provided and the concession paid to the Port. This lack of cooperation required the managing partner of this agreement, HMS Host, to issue a notice of default before the subtenant responded to the auditor's initial request.

Recommendation
We recommend Port management:

- Seek recovery of $1,703 in underpaid concession fees, late charges, and interest.

- Work with the lessee to ensure compliance with record keeping requirements and compliance with audit requirements.

Management Response

Management acknowledges that one Airport Concessions Disadvantaged Business Enterprise (ACDBE) subtenant, SeaTac Bar Group, was uncooperative with Internal Audit's requests for data and could not substantiate its reported revenue. Management further agrees with Internal Audit's assessment that the subtenant's records do not meet the requirements of the SRA agreement and, based on the records available, revenues were underreported and rent underpaid. Therefore, with respect to the findings of the current audit report:

- *Management will work with SRA to better understand the cause of their subtenant's underpaid concession fees, and recover those amounts together with late charges and interest.*

- *Management will work with SRA to bring the subtenant's accounting records into full compliance with the lease agreement.*

2. SRA DID NOT TRANSMIT ACCOUNTING RECORDS AND OTHER REQUESTED DOCUMENTS IN A TIMELY MANNER

We transmitted the audit notification letter, dated August 24, 2012, to Seattle Restaurant Associates requesting certain data be available "*…in an electronic format within two weeks following the receipt of this letter.*"

Section 7 of the lease and concession agreement requires timely availability of accounting documents for auditing purposes:

> *It is further agreed that a representative designated by the Port shall be allowed to inspect and audit Lessee's books and records with reference to the determination of any such matters at all reasonable times.*

During the engagement, the auditors experienced multiple delays in securing the records necessary to complete the audit. Because the accounting records were not maintained locally, the auditors requested SRA electronically transmit the records. The auditors accepted records in raw forms and piecemeal to expedite the process. The following schedule clearly shows that the timeline between written request and receipt were unreasonable, making the audit process inefficient:

Subtenant Records Requested	Requested Date	Received Date	Elapsed Time (In Days)
Cash Register Receipt Data (aka Point-of-Sale)	2-7-13	3-4-13 (partial)	25
Cash Register Receipt Data (aka Point-of-Sale)	2-7-13	4-17-13 (remainder)	69

Franchise Agreements	3-5-13	6-20-13	107
Schedule of Royalty Payments	3-5-13	6-20-13	107

The elapsed times exceed the "reasonable times" required under the agreement. These unreasonable times delayed the conclusion of the audit from the originally scheduled date of April 2013 to October 2013.

Recommendation

We recommend Port management continue to work with SRA to ensure compliance with the transmittal of accounting records for audit purposes.

Management Response

Management acknowledges the audit of the SRA agreement took too long to complete. However, management believes it is important to acknowledge the collaborative effort that took place between Airport and Internal Audit staff in order to achieve compliance when SRA failed to provide timely responses.

Therefore, with respect to the findings of the current audit report:

- *Management will work with SRA to address the issues with providing requested materials, including a commitment to voice confidentiality concerns immediately as they arise.*
- *As stated above, management will work with SRA to establish new protocols for review of license agreements in order to expedite this work, including pre-negotiated confidentiality agreements.*
- *Management will consider the options afforded by the lease agreement if timely transmittal is not demonstrated for future requests for records.*
- *Management will work to recover the costs of the audit.*