# INTERNAL AUDIT REPORT

## AVIATION BUSINESS DEVELOPMENT DEPARTMENT
## COMPREHENSIVE OPERATIONAL AUDIT

JANUARY 1, 2013 – JUNE 30, 2014

ISSUE DATE:  JULY 29, 2014
REPORT NO. 2014-10

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## TRANSMITTAL LETTER

Audit Committee
Port of Seattle
Seattle, Washington

We have completed an audit of the Aviation Business Development Department. We reviewed information for the period January 1, 2013 – June 30, 2014.

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 management and staff of the Aviation Business Development Department for their assistance and cooperation during the audit.

Kirangi

Joyce Kirangi, CPA, CGMA
Internal Audit, Director

| AUDIT TEAM | RESPONSIBLE MANAGEMENT TEAM |
|---|---|
| Tyler Winchell, Performance Auditor | Jim Schone, Director – Aviation Business Development |
| Brian Nancekivell, Senior Auditor | Deanna Zachrisson, Travel Dining and Retail Group Manager |
| Jack Hutchinson, Audit Manager | James Jennings, Aviation Properties Manager |
| | Jeff Wolf, Business Development Manager |
| | Jennifer Kipp, Parking Revenue Manager |

# EXECUTIVE SUMMARY

## AUDIT OBJECTIVES AND SCOPE

The purpose of the audit was to determine whether Aviation Business Development management has adequate and sufficient controls to develop and manage its agreements.

We reviewed information for the period January 1, 2013 – June 30, 2014. Details of our audit's scope and methodology are on pages 6-7.

## BACKGROUND

The Aviation Business Development Department (AVBD) is responsible for generating non-aeronautical revenues from Seattle-Tacoma International Airport (STIA) operations, which include retail concessions, rental cars, and local property development. It develops, manages, and terminates lease agreements for diverse customers including airlines, rental cars, concessionaires, and other airport-related businesses. The business agreements developed and managed by AVBD generate over $48 million in non-aeronautical revenues annually for the Port.

## AUDIT RESULT

Management controls are adequate and sufficient for developing and managing agreements.

## BACKGROUND

This is the second audit of the Port's Aviation Business Development Department (AVBD). The primary mission for AVBD is to increase STIA's non-aeronautical income from multiple business groups including travel dining and retail, rental cars, and property development. It also develops and manages hundreds of lease agreements with airlines, concessionaires, rental car companies, and other airport businesses. The Department has four groups specializing in business development:

- Travel Dining & Retail Group (TDRG): This group develops and manages all of STIA's dining and retail concessionaires. It identifies or solicits vendor interest to develop quality food, beverage, and retail concepts in the airport terminal, as well as the new Consolidated Rental Car Facility. It manages existing tenants, and oversees the tenant-marketing program to drive increases in sales across all categories.
- Aviation Properties Group (APG): Oversees all of the remaining airport properties, tenants, and agreements not overseen by TDRG. Its oversight includes rental car companies, airlines leasing terminal space, and other airport business ventures. APG is also responsible for managing all Aviation Division agreements through the Port's PROPWorks system, to ensure billings, insurance renewals, and tenant annual requirements are met.
- Parking Revenue Group (PRD): Develops, analyzes, and recommends programs to increase the Port's share of airport parking and ground transportation services revenues.
- Business Development & Analysis (BDA): This group aides the three groups above, and also evaluates the financial suitability of potential tenants, vendors, programs, and projects before they are recommended to the Aviation Investment Committee or to the Port Commission. BDA reviews multiple criteria including credit, financing, market conditions, and financial risks, and develops business cases and plans to support the efforts of other groups.

## FINANCIAL HIGHLIGHTS

The Aviation Business Development Department(AVBD) is one of the largest sources of non-aeronautical revenues in the Aviation Division. In FY 2013, agreements developed and managed directly by AVBD generated $48 million from airlines, concessionaires, rental car companies, and other customers for use of STIA's aeronautical facilities and properties. The table below shows the top five sources of departmental revenues by value and overall share, representing over 50% of total departmental revenues.

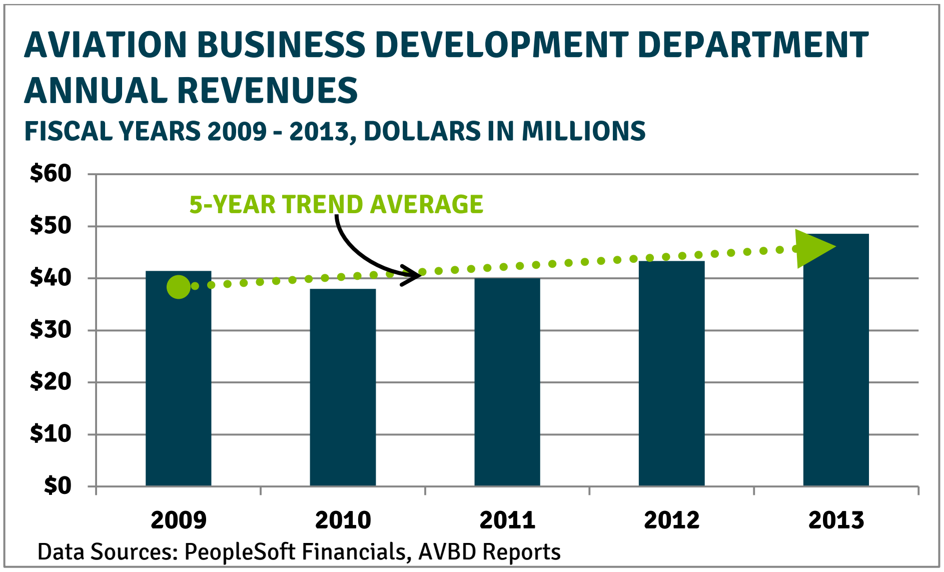
**TOP 5 SOURCES OF AVIATION BUSINESS DEVELOPMENT REVENUE AND PERCENT-SHARE**

| RANK | REVENUE SOURCE | 2011 | 2012 | 2013 | 2013 SHARE[1] |
|---|---|---|---|---|---|
| 1 | Retail[2] | $ 8,726,299 | $ 9,219,223 | $ 9,716,575 | 20% |
| 2 | In-Flight Meals | 3,732,987 | 4,486,312 | 4,813,815 | 10% |
| 3 | Food & Beverage | 3,928,609 | 4,239,946 | 4,617,400 | 10% |
| 4 | General Space Rentals | 3,390,479 | 3,353,147 | 3,150,403 | 6% |
| 5 | Advertising Display | 4,409,560 | 3,246,209 | 2,696,593 | 6% |

Data Source: PeopleSoft Financials
Data Notes: [1] The percent-share is based on the FY 2013 departmental revenues of $48,533,161.34.
[2] Retail includes multiple PeopleSoft Financial accounts described as 'retail'.

*Business Goals and Priorities*

The Port's Aviation Director has charged AVBD with increasing non-aeronautical revenue at an annual rate of 4.5% through fiscal year 2018. Non-aeronautical revenue includes any income not derived from per-use fees charged to airlines under the Signatory Lease and Operating Agreement (SLOA). Generally, non-aeronautical revenue derives from the concession operators servicing the airport terminal, rental car facility, and other airport properties. Each fiscal year, AVBD issues a strategic Business Plan that aligns its activities with its budget with attainment of the Aviation Director's goal. The chart, below, illustrates total departmental revenues for the last 5 fiscal years, and the 5-year trend average.




## HIGHLIGHTS & ACCOMPLISHMENTS

Recently, AVBD has overseen a number of significant Department accomplishments:

- Developed Master Concession Plan: A new business plan for guiding the development and organization of STIA's concession program was developed with input from the Port's customers, including passengers, airlines, concessionaires, and community members.
- Des Moines Creek Business Park: In partnership with the Real Estate Division, community partners, and Panattoni Development Company, will redevelop the Tyee Golf Course into a transit-oriented business and light-industrial park.
- Small Business Kiosk Program: A new program to provide opportunities to new and/or small business owners within under-utilized spaces in the airport terminal.
- FedEx Lease: Successfully negotiated a 15-year lease renewal with FedEx, the largest air cargo operator at STIA, under the Century Agenda priority of increasing cargo operations.

## AUDIT SCOPE AND METHODOLOGY

We reviewed information for the period January 1, 2013 - June 1, 2014. We utilized a risk-based audit approach from planning to testing. We gathered information through research, interviews, observations, and data analysis, in order to obtain a complete understanding of the operations of the Aviation Business Development Department. We assessed significant risks and identified controls to mitigate those risks. We evaluated whether the controls were functioning as intended. We applied additional detailed audit procedures to areas with the highest likelihood of significant negative impact as follows:

1) To determine whether management has adequate and sufficient controls for developing agreements:

    Determine whether agreements developed within the audit period were in compliance with Port policies and procedures (using a risk-based sample of up to 10 agreements executed during FY 2013):
    - i) Financial analysis was conducted (RE-2 Procedure, 1.G, 2.A)
    - ii) Port Counsel reviewed the final agreements (RE-1 Procedure, II.A.b)
    - iii) Tenant Risk Analysis was conducted (RE-2 Procedure, 1.G, 2.A);
    - iv) Insurance and Surety were obtained/verified prior to tenant's occupancy;

2) To determine whether management has adequate and sufficient controls to manage agreements:

    a) Determine if key management processes are adequately documented:
        - i) Management processes for Aviation Properties.
        - ii) Management processes for Travel Dining & Retail.

    b) Determine the sufficiency of risk management processes, including, evaluation of:
        - i) Extent of prior, repeat audit findings and mitigation strategies.
        - ii) Extent of vendor risk management processes.
        - iii) Quality assurance audit processes.
        - iv) Financial monitoring processes.
        - v) Processes for mitigating conflicts of interest.

    c) Determine whether industry Best Practices (recognized by the Airport Cooperative Research Program/Airports Council International, N.A) are utilized as part of key management processes for:
        - i) Developing agreements.
        - ii) Managing agreements.
        - iii) Managing vendor marketing.
        - iv) Managing ACDBE tenant/subtenants.

## CONCLUSION

Management controls are adequate and sufficient for developing and managing agreements.