INTERNAL AUDIT REPORT

LIMITED CONTRACT COMPLIANCE
ANTON AIRFOOD OF SEATTLE, INC.

APRIL 1, 2016 – MARCH 31, 2019

ISSUE DATE: JUNE 21, 2019
REPORT NO. 2019-07

Port of Seattle | INTERNAL AUDIT

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EXECUTIVE SUMMARY

Internal Audit (IA) completed an audit of the Seattle-Tacoma International Airport (Airport) Restaurant Lease Agreement (Agreement) between Anton Airfood of Seattle, Inc. (Anton) and the Port of Seattle (Port). Anton, which is managed by Host International, Inc. (Host), operated Anthony's Restaurant and Anthony's Fish Bar in the airport's central terminal. The lease expired March 31, 2019.

The period audited was April 1, 2016 through March 31, 2019. The audit was performed to determine whether Anton complied with significant provisions of the Agreement including whether reported gross revenues and percentage rent paid to the Port were complete and accurate.

Our audit identified the following two issues:

1. (High) - The Agreement requires the Lessee, in part, maintain records for a period of three years. Anton did not provide a complete chart of accounts, the daily point of sales data, cash register z-tapes and guest checks in its original format resulting in a scope limitation. Accordingly, Internal Audit was unable to obtain sufficient and appropriate audit evidence to provide reasonable assurance of the accuracy and completeness of concession revenue.

2. (Medium) - Anton did not report $42,022.90 in gross revenue in January 2019. According to Host, a new item was added to the menu which prevented the daily sales data from uploading to the general ledger. As a result, $5,420.46 in additional percentage fees is due to the Port.

The issues are discussed in more detail on page six.

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

Glenn Fernandes, CPA
Director, Internal Audit

<u>RESPONSIBLE MANAGEMENT TEAM</u>
Dawn Hunter, Senior Manager, Airport Dining & Retail
Linda Nelson, Manager, Aviation Finance & Budget
Jim Schone, Director, Aviation Commercial Management

BACKGROUND

Anton Airfood operated Anthony's Restaurant and Anthony's Fish Bar in the airport's central terminal. The lease expired March 31, 2019.

In March 2003, the Port entered into a Lease Agreement with Anton. The Agreement sets a fixed Minimum Rent and requires additional Percentage Rent from gross sales of food and beverage, as well as any other sales. The lessee contributes an amount of 0.5% of the monthly Gross Receipts (capped at $24,000 per agreement year) as marketing fee to fund the Marketing Program.

Effective July 2015, concession fees were established at 8.0% of gross sales, up to the first $5 million of annual gross sales, 10.0% between $5 million to $10 million and 12.0% above $10 million. The Port and Lessee agree the first 7.0% of the Gross Receipts paid shall be Contract Rent for use of the premise. Excise tax of 12.84% is calculated, based on the contract rent, and is added to the concession fee.

The monthly concession fee is due on or before the fifteenth day of each succeeding month. For each Agreement Year, an Annual Report of Gross Receipts for the preceding Agreement Year must be certified by a Chief Financial Officer and/or Chief Executive Officer of the Lessee and submitted to the Port within 60 days of each Agreement Year-end.

The table below reflects the total concession revenue reported to the Port during the audit period:

Year	**Gross Revenue**	**Percentage Fees Paid**
April 2016 – March 2017	$18,153,082	$2,065,530
April 2017 – March 2018	$19,342,935	$2,219,007
April 2018 – March 2019	$20,096,378	$2,316,192
Total	$57,592,395	$6,600,729

Source: AFR YE files, PeopleSoft, Anton's certified revenue reports.

Percentage Fees Paid, in above table, are calculated based on agreement year.

AUDIT SCOPE AND METHODOLOGY

We conducted this 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The period audited was April 2016 through March 2019. After identifying the significant provisions in the Agreement, we performed the following audit procedures:

<u>Revenue Completeness, Accuracy, Timeliness</u>

- Reconciled all revenues reported to the Port, to the Lessee's general ledger, and to revenue reports certified by Anton's CFO.
- Reviewed the Certified Statement of Gross Revenues for compliance with timely and complete submission requirements.
- Verified timeliness of payments for all months in the audit period.

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

1) RATING: HIGH

The Agreement requires the Lessee, in part, maintain records for a period of three years. Anton did not provide a complete chart of accounts, the daily point of sale data, cash register z-tapes and guest checks in its original format resulting in a scope limitation. Accordingly, Internal Audit was unable to obtain sufficient and appropriate audit evidence to provide reasonable assurance of the accuracy and completeness of concession revenue.

Section 7 of the Agreement reflects the "Lessee shall retain all accounting records, including cash register tapes and **guest checks**, for not less than (3) years after the close of the applicable Agreement Year or until the close of any ongoing audit thereof being conducted by, or on behalf of, the Port, whichever shall last occur."

Anton did not provide a complete chart of accounts nor retain original receipt data to evidence their daily sales. Excel reports that display information, although unlikely, can be manipulated. Data can be inadvertently removed, thus compromising the completeness and accuracy of the report. Relying on reports that capture information downloaded from another source, therefore, does not provide the same level of assurance as does obtaining data in its original form (i.e. guest checks).

We escalated the issue to Host's Vice President of Business Development who appreciated our position and requested Host's accounting team provide a PDF document hoping it would illustrate that it couldn't be modified. However, like excel downloads, these documents could also be modified, simply be right clicking and selecting "Edit Text & Images."

This position is also consistent with the Internal Revenue Service record retention guidance which requires cash register z-tapes and detailed z-tapes to perform their examinations.

As a result, Internal Audit was unable to trace source data (i.e. guest checks) to revenue that had been reported to the Port during the scope period. We were also unable to validate, other than verbal descriptions provided by Host, check numbers that were missing from a sequential listing.

Recommendations:

Management should proactively communicate contractual lease requirements with concessionaires and periodically review concessionaire documentation to ensure lease and revenue compliance.

Management Response/Action Plan

Management agrees with this finding. Airport Dining and Retail staff continues to work with Host and Internal Audit staff to resolve this specific issue and will emphasize to all ADR tenants, the need to maintain accounting records for three (3) years so as to avoid this problem in the future.

2) RATING: MEDIUM

Anton did not report $42,022.90 in gross revenue in January 2019. According to Host, a new item was added to the menu which prevented the daily sales data from uploading to the general ledger. As a result, $5,420.46 in additional percentage fees is due to the Port.

Host initially communicated that the error had been identified and corrected in February 2019 and as a result, no additional monies were owed. Host also indicated that they would provide supporting documentation to evidence the correction, however no documentation was provided.

In the absence of supporting documentation, Internal Audit analyzed the daily sales for February 2019 and did not identify any dates showing a significant increase in revenue.

As a result, we engaged the Port's Airport Dining and Retail Management team and Host's, Vice President of Business Development. We again asked for the documentation which they indicated they would provide. Subsequent to the meeting, Host communicated that the error **had not** been corrected and agreed that the additional monies were due.

The table below reflects the calculation of the $5,420 owed:

Period (2019)	Difference	Concession fees (12%)	Excise Tax*	Percentage Fees due
January	$42,023	$5,042	$378	$5,420

Data Source: PeopleSoft Financials, Peoplesoft Financials, and Anton records.
* Excise tax of 12.84% is calculated based on contract rent, which is the first 7% of Gross Receipts.

Recommendations:

1. Seek and recover $5,420.46 in underpaid Percentage Fees.
2. Assess the applicability of a one-time late charge and any accrued interest.

Management Response/Action Plan:

Management was unaware of the problem affecting the daily sales data uploading to the general ledger until this audit. ADR staff will request that an invoice be sent to Host for the monies owed including interest and late fees. Also, ADR staff will implement a system requiring all ADR tenants to provide formal documentation of such problems in the future at the time of occurrence in the form of a certified letter to the ADR Senior Manager detailing such discrepancies for inclusion in the correspondence file.

APPENDIX A: RISK RATINGS

Findings identified during the course of the audit are assigned a risk rating, as outlined in the table below. The risk rating is based on the financial, operational, compliance or reputational impact the issue identified has on the Port. Items deemed "Low Risk" will be considered "Exit Items" and will not be brought to the final report.

Rating	Financial	Internal Controls	Compliance	Public	Port Commission/ Management
HIGH	Large financial impact Remiss in responsibilities of being a custodian of public trust	Missing, or inadequate key internal controls	Noncompliance with applicable Federal, State, and Local Laws, or Port Policies	High probability for external audit issues and/or negative public perception	Important Requires immediate attention
MEDIUM	Moderate financial impact	Partial controls Not adequate to identify noncompliance or misappropriation timely	Inconsistent compliance with Federal, State, and Local Laws, or Port Policies	Potential for external audit issues and/or negative public perception	Relatively important May or may not require immediate attention
LOW/ Exit Items	Low financial impact	Internal controls in place but not consistently efficient or effective Implementing/enhancing controls could prevent future problems	Generally, complies with Federal, State and Local Laws or Port Policies, but some minor discrepancies exist	Low probability for external audit issues and/or negative public perception	Lower significance May not require immediate attention
Efficiency Opportunity	An efficiency opportunity is where controls are functioning as intended; however, a modification would make the process more efficient				