INTERNAL AUDIT REPORT

Limited Contract Compliance Audit
Concourse Concessions LLC

January 1, 2017 – December 31, 2019

Issue Date: September 10, 2020
Report No. 2020-08

Port of Seattle | INTERNAL AUDIT

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Executive Summary

Internal Audit (IA) completed an audit of the Lease Agreement (Agreement) between Concourse Concessions LLC and the Port of Seattle (Port). The Period audited was January 1, 2017 through December 31, 2019. The audit was performed to determine whether Concourse Concessions complied with significant provisions of the Agreement, including whether reported gross revenues and percentage fees were complete and accurate.

Our audit identified the following two issues:

1) **(Medium)** – Effective April 1, 2018, the Minimum Annual Guarantee (MAG) was removed from the Agreement. As a result, the criteria, previously used to calculate the security deposit, was eliminated and the Port was unable to verify the reasonableness of the current security deposit.
2) **(Low)** – Concourse Concessions did not report $12,721 in gross revenue during the period under audit. These amounts were from cash shortages that Concourse Concessions removed from their revenue reports prior to submittal to the Port. As a result, approximately $1,527 in additional percentage fees are due to the Port.

The issues are discussed in more detail on page six.

We extend our appreciation to management and staff of the Airport Dining and Retail, the Aviation Finance and Budget, and the Accounting and Financial Reporting (AFR) departments for their assistance and cooperation during the audit.

Glenn C Fernandes

Glenn Fernandes, CPA
Director, Internal Audit

RESPONSIBLE MANAGEMENT TEAM
Dawn Hunter, Director, Aviation Business Development
Khalia Moore, Senior Business Manager, Airport Dining and Retail

Background

Concourse Concessions, headquartered in Washington State, was founded in 2002 with operations starting at Seattle-Tacoma International Airport in June of 2004. The Port has two active agreements with Concourse Concessions; Agreement Numbers: 002055 and 002362. The locations covered by these agreements were Waji's, Caffe D'arte, La Pisa Café, and Coffee Bean and Tea Leaf. Based on the risk assessment conducted for 2020 audit plan, we selected Agreement No. 002055 for our audit.

The Port entered into Agreement No. 002055 on June 22, 2016, with a commencement date of January 1, 2017 and an expiration date of December 31, 2023. The Agreement included the following three locations:

- La Pisa Café
- Waji's
- Coffee Bean and Tea Leaf (lease terminated in September of 2019)

The original terms of the lease required a Minimum Annual Guarantee (MAG) equal to 90% of the prior year's determined rent or a monthly rent based on the percentages by location and concession category, whichever is higher. Effective April 1, 2018, the Lease Agreement was amended and eliminated the MAG. Additionally, the amended Agreement required Concourse Concessions to pay the Port a graduated percentage fee based on combined annual gross receipts as shown in the table below. The Percentage Fee is due by the 15th of the following month.

Combined Annual Gross Receipts	Percentage of Gross Sales
Less than or equal to $2,000,000	12.0%
Greater than $2,000,000 but less than or equal to $4,000,000	13.0%
Greater than $4,000,000	15.0%

The table below reflects the Gross Revenues as reported by Concourse Concessions and the Minimum Annual Guarantee (MAG) and Percentage Fees, as billed by the Port of Seattle.

Year	Gross Revenue	MAG[1]	Percentage Fees	Total Rent
2017	$7,434,388	$715,776	$259,260	$975,036
2018	$7,539,330	$203,963[2]	$794,193	$998,156
2019	$7,199,177		$1,066,003	$1,066,003
Total	**$22,172,895**	**$919,739**	**$2,119,456**	**$3,039,195**

Source: Concourse Concessions Monthly Revenue Reports; PeopleSoft Financials, AFR year-end documents

[1] MAG was used for "Minimum Rent" but was eliminated on April 1, 2018.

[2] MAG for 2018 reflects three months; January – March.

Audit Scope and Methodology

We conducted the engagement 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 conduct an engagement to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our engagement objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions, based on our engagement objectives.

The period audited was January 2017 through December 2019. After identifying significant provisions in the Agreement, we performed the following audit procedures:

Revenue Completeness and Accuracy

- Traced concession payments to the Port records to verify payments were received by Agreement dates.
- Agreed revenues reported to the Port, to the Concessionaire's monthly revenue reports, charge sheets, and to independently audited schedules.
- Analyzed deductions in the data sheets to determine whether they were properly classified and correctly deducted from the gross revenues, as provided in the Lease Agreement.

Surety

- Reviewed the Concessionaire's Rent Security Deposit for compliance with the Lease Agreement, the Port Policy (Port RE-2) and Washington State Law (RCW 53.08.085).

Schedule of Findings and Recommendations

1) Rating: Medium

Effective April 1, 2018, the Minimum Annual Guarantee (MAG) was removed from the Agreement. As a result, the criteria, previously used to calculate the security deposit, was eliminated and the Port was unable to verify the reasonableness of the current security deposit.

A valid and adequate security deposit is important in the event the lessee fails to pay amounts owed or goes out of business.

State law (RCW 53.08.085), requires the surety to be an amount equal to one-sixth of the total rent, but not less than an amount equal to one year's rent or more than an amount equal to three years' rent. One year's surety would have been $715,776 in 2017; equal to one year's MAG, however the law allows the Port Commission to waive the rent security requirement, or lower the amount, at their discretion, which the Port chose to do by approving Policy RE-2 (RE-2). Surety for 2017 was set at $357,888.

The Port Commission approved RE-2 which provides guidelines for the calculation of surety. The Policy was last updated on October 20, 1995 and per this policy, if the term of the agreement is five years or more, the security deposit should be an amount equal to six months of rent. After consulting with Legal, Aviation Properties confirmed that rent, per RE-2 refers to the MAG. RE-2 does not provide criteria to calculate a security deposit amount in situations when there is no MAG.

In alignment with RE-2 the Agreement requires the lessee to obtain and deliver to the Port an irrevocable stand-by letter of credit, a bond, or other security deposit in a form approved by the Port. The security deposit must be an amount equal to one-half of the MAG, however, there was an amendment to the Agreement, in April of 2018, that eliminated the MAG. Section 11.1 of the Agreement was not updated to align with the amended terms, resulting in the elimination of the criteria needed to calculate the security deposit.

The current surety amount of $357,888 was calculated based on the first year's MAG (2017). Once the MAG was eliminated in 2018, the surety amount was carried forward without adjustment due to the absence of a criteria in the amendment.

Additionally, in order to provide relief to concessionaires, because of business closures related to the COVID-19 pandemic, the Port eliminated MAG requirements for the period of March 2020 through December 2020. With the elimination of MAGs, there is a potential that the Port may encounter an issue like the one discussed above.

Recommendations:

1) Policy RE-2 should be reviewed and revised to address the issues identified above.
2) The Agreement should be amended to include criteria for the security deposit calculation, in alignment with the revised Port RE-2 policy.

Management Response/Action Plan:

Management has identified that this is an issue within many contracts outside of the current contract undergoing audit. Management is seeking Legal review and recommendations for modifications of the Port Policy RE-2 as the current policy is not aligned with industry standards, does not account for varying contract terms, and could be considered a barrier to entry for many small and minority businesses.

DUE DATE: 12/31/2020

2) Rating: Low

Concourse Concessions did not report $12,721 in gross revenue during the period under audit. These amounts were from cash shortages that Concourse Concessions removed from their revenue reports prior to submittal to the Port. As a result, approximately $1,527 in additional percentage fees are due to the Port.

Cash "Short/Over" is an income statement account within the company's general ledger, where Concourse Concessions records any over or under cash between the daily cash receipts and what is counted in the cash register.

During the three-year audit period, $12,721 was coded as cash shortages and was not included in the revenues reported to the Port. The Agreement does not list cash shortage as an allowable deduction from gross revenues.

Prior to the first amendment of the contract, percentage fees were billed according to the following concession categories:

Concession Category	Percentage of Gross Receipts
A. Non-Branded Food and Beverage	13.5%
B. Branded Food and Beverage	11.5%
C. Alcohol, Beer, and Wine	17.5%
D. Souvenir Merchandise	26.5%
E. Advertising and All Others	14.5%

The cash shortage was listed as a monthly lump sum amount, and not separated by category. Therefore, Internal Audit was unable to accurately calculate the amount due to the Port. To determine a reasonable estimate of the percentage fee due, Internal Audit used the lowest rate applicable in the current tier system, which is 12% (refer to the table on page 4). As a result, approximately $1,527 is due to the Port.

Recommendation:
1. Seek and recover $1,527 in underpaid percentage fee.

Management Response/Action Plan:
Management has identified that the tenant did in fact understate their revenues generated at the airport resulting in an incorrect billing of percentage fees due to the Port by the tenant. Management will be seeking immediate payment of fund from the tenant once a final amount (amount owed including interest and late fees) has been determined.

DUE DATE: 12/31/2020

Appendix A: Risk Ratings

Findings identified during the audit are assigned a risk rating, as outlined in the table below. Only one of the criteria needs to be met for a finding to be rated High, Medium, or Low. Findings rated Low will be evaluated and may or may not be reflected in the final report.

Rating	Financial Stewardship	Internal Controls	Compliance	Public	Commission/ Management
High	Significant	Missing or not followed	Non-compliance with Laws, Port Policies, Contracts	High probability for external audit issues and / or negative public perception	Requires immediate attention
Medium	Moderate	Partial controls Not functioning effectively	Partial compliance with Laws, Port Policies Contracts	Potential for external audit issues and / or negative public perception	Requires attention
Low	Minimal	Functioning as intended but could be enhanced to improve efficiency	Mostly complies with Laws, Port Policies, Contracts	Low probability for external audit issues and/or negative public perception	Does not require immediate attention