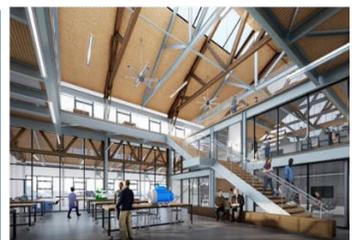


INTERNAL AUDIT REPORT



Operational Audit
Rent and Concession Deferral Recovery

April 2020 – October 2021

Issue Date: November 5, 2021
Report No. 2021-18

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Executive Summary

Internal Audit completed an audit of the Rent and Concession Deferral Recovery Program (Program) for the period April 2020 through October 2021. The audit was performed to evaluate current processes and related internal controls to assure Program compliance with applicable laws and Port of Seattle (Port) policies, and safeguarding of Port resources.

On March 23, 2020, in response to the COVID-19 pandemic, Governor Jay Inslee imposed the Stay Home – Stay Healthy Order throughout Washington State. In an effort to slow the spread of the virus, non-essential businesses were strongly encouraged to immediately cease operations, other than performance of basic minimum operations. Since April 2020, the Port Commission has authorized short-term economic relief to customers, airlines, concessionaires, and tenants located at various Port properties to address impacts of the economic crisis resulting from the COVID-19 pandemic. Based on approvals by Port Commission via Motions 2020-07 and 2020-13, the Port created and implemented the Program, to ensure financial support to the local economy and to protect the Port's assets. The Program accomplishes the Port's goals of "supporting regional economic vitality; environmental stewardship; and equity and inclusion."

The Port and the tenants or concessionaires entered into deferral agreements detailing the arrangement that includes a repayment plan with interest to be paid on deferred amounts, and a waiver of other late fees and finance charges. As of December 31, 2020, the deferred charges were \$61.1MM, including \$4.1MM of Norwegian Cruise Line Holdings (NCL). As of October 27, 2021, the outstanding deferred charges were \$2.7MM, of which NCL had the largest balance of \$2MM.

Through document review and inquiries with 13 business leaders, Internal Audit identified monitoring controls that are significant to the current processes, including: the Executive Director's quarterly recovery status/action reporting to the Commission, Legal department's involvement/oversight, Executive oversight meetings, business leaders' ongoing monitoring engagement, centralized function's use of a tracking tool, and an associated quality review by Accounting and Financial Reporting (AFR). Business leaders also expressed concern about the uncertainty of the COVID-19 pandemic, Centers for Disease Control and Prevention (CDC) requirements, and the related impact on the Port and tenants. Internal Audit performed detail testing for a sample of six deferral agreements and noted that participating tenants were compliant with Program requirements.

Based on the work we performed, Internal Audit concluded that the current processes and related internal controls are operating as intended, to assure Program compliance with applicable laws and Port policies.

Internal Audit would like to thank AFR, Legal, Lease Administration, Finance & Budget, and all Divisions/Departments that participated in information gathering, for their cooperation and partnership during this audit.



Glenn Fernandes, CPA
Director, Internal Audit

Responsible Management Team

Rudy Caluza, Director, Accounting and Financial Reporting

Dawn Hunter, Director, Aviation Commercial Management

Lisa Lam, Assistant Director, Accounting and Financial Reporting

Melinda Miller, Director, Portfolio and Asset Management

Background

On March 23, 2020, in response to the COVID-19 pandemic, Governor Jay Inslee imposed the Stay Home – Stay Healthy Order throughout Washington State. In an effort to slow the spread of the virus, non-essential businesses were strongly encouraged to immediately cease operations other than performance of basic minimum operations. The Port of Seattle (Port) received questions and concerns from tenants and concessionaires regarding the uncertainty and decline of revenues that were correspondingly impacting their ability to make payments.

Since April 2020, the Port Commission has approved the following Motions and Order, and authorized short-term economic relief to customers, airlines, concessionaires, and tenants:

- Motion 2020-06: Provided guidance for Port leadership in prioritizing Port investments to assist local, regional, and statewide economic recovery from the COVID-19 pandemic.
- Motion 2020-07: Provided immediate relief and support to Port employees, Port tenants, and concessionaires. Also authorized the Executive Director to approve further relief depending on the economic conditions facing businesses on airport and non-airport Port properties.
- Motion 2020-13: Authorized adjustments to leases and the temporary suspension of the Minimum Annual Guarantee (MAG) for Airport Dining and Retail tenants.
- Order 2020-21: Authorized additional short-term adjustments to agreements for tenants and concessionaires, consistent with April 1, 2020 direction on relief measures.

The Port created and implemented the Rent and Concession Deferral Recovery Program (Program), to provide financial support to the local economy and to protect the Port's assets. The Program accomplishes the Port's goals of "supporting regional economic vitality; environmental stewardship; and equity and inclusion." The Port and the tenants or concessionaires entered into deferral agreements detailing the arrangement that includes a repayment plan with interest to be paid on deferred amounts, and a waiver of other late fees and finance charges. A memo entitled, "Accounting Treatment of Rent Deferral Payment Plans" ("White Paper"), which was prepared by the Assistant Director, Accounting and Financial Reporting (AFR), described the key provisions of the deferral agreements by business or operation, and related technical matters:

Deferred Charges

Depending on the operation group type, the deferred charges mostly ranged from March 2020 through March 2021 with a few exceptions. No finance charges or late fees were included as deferred charges. For customers who had already paid the deferred charges prior to the execution of the deferral agreement, the paid amount was excluded from the deferred charges.

Repayment Plan

Depending on the operation group type, the deferred amount was either due on October 1, 2020 or monthly installments generally began on July 1, 2020. Some installments went beyond 2022 (e.g., Cruise lines January - April 2022).

Interest

Depending on the operation type group, the Port charged a one percent interest per annum on unpaid deferred charges extending for more than one year from original due dates.

Accounting Treatment & Guidance

The Port recorded the deferred charges as revenue earned and accounts receivable, during the period in which services were provided. The Port followed the specific guidance addressed through the Financial Accounting Standards Board (FASB) Staff Q&A and Federal Aviation Administration (FAA) guidance to airport sponsors related to COVID-19 accommodations, specifically on "Deferral of rental payments or other fees."

Rent and Concession Deferral Recovery

As displayed in the table below, as of December 31, 2020, the total deferred charges were \$61.1MM, including \$4.1MM of Norwegian Cruise Line Holdings (NCL). As of October 27, 2021, the outstanding deferred charges were \$2.7MM, of which NCL had the largest balance of \$2MM.

Business Group	No. of Customer	Deferred Amount (Invoiced Amount)	AR at 12/31/2020	No. of Customer Paid off	No. of Customer - Remaining	Est. Current AR at 12/31/2020	Est. Noncurrent AR at 12/31/2020
Aero (SLOA)	30	\$ 37,584,122	\$ -	30	0	\$ -	\$ -
ADR	37	\$ 8,602,735	\$ 4,115,772	11	26	\$ 4,115,772	\$ -
Rental Car	9	\$ 4,375,846	\$ 1,128,896	3	6	\$ 1,128,896	\$ -
Airline Service Providers	9	\$ 2,307,686	\$ 1,889,667	4	5	\$ 1,889,667	\$ -
GT Per Trip	120	\$ 196,109	\$ 8,170	101	19	\$ 8,170	\$ -
GT Space	3	\$ 12,409	\$ 9,450	1	2	\$ 9,450	\$ -
GT-STILA	1	\$ 51,826	\$ 51,426	0	1	\$ 51,426	\$ -
ATZ	1	\$ 293,758	\$ 249,953	0	1	\$ 249,953	\$ -
Flight Kitchen	3	\$ 1,379,484	\$ 578,629	1	2	\$ 578,629	\$ -
Taxi	124	\$ 91,230	\$ 79,755	23	101	\$ 79,755	\$ -
Aviation	337	\$ 54,895,206	\$ 8,111,718	174	163	\$ 8,111,718	\$ -
Salmon Bay Marina	2	\$ 3,359	\$ 482	1	1	\$ 482	\$ -
Fishermen's Terminal	6	\$ 79,770	\$ 70,729	2	4	\$ 70,729	\$ -
Harbor Island Marina	2	\$ 1,999	\$ 1,173	0	2	\$ 1,173	\$ -
Shilshole Bay Marina	31	\$ 233,263	\$ 103,782	7	24	\$ 78,958.45	\$ 24,823.20
Terminal 91	1	\$ 26,517	\$ 8,839	0	1	\$ 8,839	\$ -
Cruise	1	\$ 16,574	\$ 15,791	1	0	\$ 14,410	\$ 1,381
Portfolio Management	36	\$ 1,757,448	\$ 813,554	13	23	\$ 715,844	\$ 97,710.30
Non-Aviation	79	\$ 2,118,931	\$ 1,014,350	24	55	\$ 890,435	\$ 123,915
Total	416	\$ 57,014,136	\$ 9,126,068	198	218	\$ 9,002,153	\$ 123,915
Cruise - NCL		\$ 4,107,531	\$ 4,107,531			\$ 1,858,169	\$ 2,249,363
TOTAL (Including NCL)		\$ 61,121,668	\$ 13,233,599			\$ 10,860,322	\$ 2,373,277

[Source: Port of Seattle Memorandum: Accounting Treatment of Rent Deferral Payment Plans ("White Paper"), dated September 21, 2020 & most recently updated, September 20, 2021]

Through document review and inquiries with 13 business leaders, Internal Audit identified monitoring controls that are significant to the current processes, including the following:

- The Executive Director's quarterly recovery status/action reporting to the Commission for transparency and oversight.
- Legal's oversight of and involvement in all phases of the Program to assure the program intent, legality, consistency with the Port Commission guidance, and ongoing issue resolution as arising.
- Executive oversight meetings, so called, "3R" (Relief, Reopening, Recovery) meetings, where the Executive Director, Managing Directors and/or Directors, General Counsel, Chief Financial Officer, Executive Chief of Staff, and other key stakeholders are informed of what Divisions/leaders are deciding or proposing.
- Business leaders' active engagement in the ongoing Program monitoring of outstanding AR balances, delinquencies, default/bankruptcies, etc., via regular and ad-hoc status/review meetings and other communication methods, with AFR and other key stakeholders (e.g., Legal, Finance & Budget, and Lease Administration).
- AFR's centralized function for deferral agreement record retention, and billing/collection/accounting/tracking of deferred rent.
- A centralized tracking mechanism, to monitor the deferrals/repayment plan status, utilizing AFR's tracking spreadsheet.

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, 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 findings and conclusions based on our engagement objectives.

We used a judgmental method to determine the samples selected for our audit test work. The results of this work cannot be projected to the population as we did not select a random sample.

The period audited was April 2020 through October 2021 and included the following audit procedures:

Program Documentation, Approval, and Communication

- Gained an understanding of the program structure/content, scope, and timeline.
- Reviewed the relevant documentation to determine if the program was developed, documented, reviewed/approved, and communicated to Port employees, tenants, and the public.
- Analyzed the relevant program data (including the AFR deferral tracking Excel spreadsheet, named “2020 Deferral Payment Plans”) to identify the, total population of the deferred rents, distribution among business groups, total deferred amounts, paid amounts, and current AR outstanding balances.

Applicable Laws and Policy Compliance

- Gained understanding of the requirements under the applicable laws, policies, and procedures.
- Reviewed the relevant documentation to determine if the Program complied with applicable laws, policies, and procedures.

[Note: For this procedure, Internal Audit partially relied on the work performed by the Washington State Auditor Office as part of the Accountability Audit for the operating year 2019.]

Program Components for Safeguarding of Port Resources

- Gained an understanding of the program structure/content.
- Reviewed the relevant documentation to determine if the Program clearly specified requirements.

Monitoring Process & Related Communication/Information Flow

- Inquired with the following Port management:
 - Assistant Director, Accounting and Financial Reporting
 - Deputy General Counsel
 - Director, Aviation Business and Property
 - Director, Aviation Commercial Management
 - Senior Manager, Aviation Business Development
 - Senior Manager, Aviation Finance and Budget
 - Manager, Aviation Lease Administration
 - Manager, Airport Landside Operations
 - Director, Portfolio and Asset Management
 - Director, Maritime Operations and Security
 - Director, Maritime Finance and Budget
 - Cruise Operations and Business Development Manager
 - Manager, Lease Management and Utility Management, Portfolio Management
- Gained an understanding of the monitoring process and related controls/gaps (if any) to assure the tenants' program compliance, collectability, and whether exceptions are detected/reported.

Participating Tenants' Program Compliance

- Obtained a list of tenants that had deferred their rent for the period under audit. Judgmentally selected a sample of six deferral agreements. Included in the sample was one of the five deferral agreements signed by tenants in the World Trade Center; the billing and collection of which is managed by Kidder Matthews, the third-party property management company.
- Reviewed the relevant documentation for the above sample to test attributes, including the following:
 - Approval/sign-off of deferral agreements/amendments
 - Valid lease agreements
 - Consistency of deferral charges/repayment plans with the Port policy/procedures
 - Valid reasons for adjustments, write-offs, and credit memos
 - Interest calculation accuracy
 - Consistency of deferral charges/repayment plans among tenants
 - Repayments, default/collection cases, and collectability

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