Internal Audit Report

Flying Food Services, Inc

Lease and Concession Compliance Audit

January 1, 2008 through December 31, 2009

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Report No. 2010-13

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Internal Auditor's Report

We have completed an audit of the Lease and Concession Agreement, as amended, between the Port of Seattle and Flying Food Services. The purpose of the audit was to determine whether:

1) Reported concession was complete, properly calculated and remitted timely to the Port.
2) Port and the lessee complied with provisions of the Lease and Concession Agreement.
3) Lease and Concession Agreement, as amended, complies with applicable state and Port requirements.

We examined information related to a two-year period from January 1, 2008, through December 31, 2009.

We conducted our audit using due professional care. We planned and performed the audit to obtain reasonable assurance as to compliance with significant provisions of the agreement, including complete and timely reporting of concessionable revenues.

Flying Food Services materially complied with the terms of the Lease and Concession agreement, and the agreement itself complies with applicable state and Port requirements.

As referenced in the audit report, the audit disclosed revenue misclassifications and instances of late payments.

We extend our appreciation to the management and staff of Aviation Business Development, and Accounting & Financial Reporting for their assistance and cooperation during the audit.

Kirangi

Joyce Kirangi, CPA
Director, Internal Audit

Executive Summary

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

1) Reported concession was complete, properly calculated and remitted timely to the Port.
2) Port and the lessee complied with provisions of the Lease and Concession Agreement.
3) Lease and Concession Agreement, as amended, complies with applicable state and Port requirements.

We examined the books and records of Flying Food Services for a two-year period from January 1, 2008 through December 31, 2009. Aviation Business Development has the primary responsibility for administering and monitoring the agreement to ensure compliance with agreed-upon terms.

Agreement Terms Flying Food Services (FFS) provides in-flight catering service, including the preparation and distribution of in-flight foods, beverages, and related services to scheduled, non-scheduled, and commuter airlines.

The terms of the agreement provide for a 7% concession fee on the gross sales for catering services to airlines, and a 3.5% concession fee on the gross sales to non-airline parties, with only the following acceptable offsets or deductions:

1) Returns and refunds
2) Taxes imposed and collected by Lessee as agent for its taxing body
3) Meals furnished to employees of Lessee

A monthly rent is payable in advance, on or before the first day of each month, without notice from the Port. The concession is due within 15 days from the end of each calendar month. For untimely payments, the agreement provides interest to be accrued from the due date until paid.

Audit Result Summary Flying Food Services materially complied with the terms of the Lease and Concession agreement. Further, the agreement itself complied with applicable state and Port requirements. The audit; however, disclosed that certain airline sales (subject to 7% concession) were reported as non-airline sales (subject to 3.5% concession). Additionally, we noted instances of late payments, ranging from 2 to 14 days. The noted exceptions as a whole resulted in approximately $27,802 in additional concession fees and interest. The auditor suggests recovery of this amount.

Background

The first agreement on this lease was originally signed with MOCO, Inc in 1988. Later in the same year, the lease was subleased to Flying Food Services, Inc. At a later time, the lease agreement was assigned, with Port's consent, to Flying Food Services in May 1990.

Flying Food Services, Inc. (FFS) provides in-flight catering services that consist of the preparation and distribution of in-flight foods, beverages, and related services to domestic and overseas airlines at Seattle-Tacoma International Airport. The terms of the lease provide for a percentage fee of 7% on gross sales for catering services to the airlines, and 3.5% on gross sales to non-airline parties located outside the Airport.

FFS is also required to remit a minimum rent that is due on the first of each month. The concession fee is due within fifteen (15) days following the end of each calendar month.

Year	Reported Gross Revenue	Paid Concession
2007	14,996,854	1,088,030
2008	13,355,031	983,987
2009	12,277,511	845,402
Total	40,629,396	$2,917,419

Source: PROPworks and PeopleSoft

Audit Objectives

The objective of our audit was to determine the following:

1) Reported concession was complete, properly calculated and remitted timely to the Port.
2) Port and the lessee complied with provisions of the Lease and Concession Agreement.
3) Lease and Concession Agreement, as amended, complies with applicable state and Port requirements.

Audit Scope

The scope of the audit covered the period of January 1, 2008 through December 31, 2009.

Audit Approach

To achieve our audit objectives, we performed the following procedures:

- Read and analyzed the lease agreement, as amended.
- Reviewed applicable state and local rules and regulations.
- Identified significant provisions in the lease agreement.
- Obtained necessary financial and non-financial data from the lessee.

- Assessed relevant risks associated with the agreement.
- Designed and executed audit procedures based on risk.
- Analyzed data (internal & external) to determine accuracy, completeness, and compliance. This included performing the following additional procedures:

    - Reconciliation of the reported gross receipts to the lessee's accounting records to ensure completeness and consistency.
    - Reconciliation of the certified Audited Schedule of Gross Receipts to lessee's accounting records to ensure completeness.
    - Verified that concession fees were paid timely and intact.
    - Recalculated concession revenue and related fees to ensure accuracy.

Conclusion

Flying Food Services materially complied with the terms of the Lease and Concession agreement. Further, the agreement itself complied with applicable state and Port requirements. The audit; however, disclosed that certain airline sales (subject to 7% concession) were reported as non-airline sales (subject to 3.5% concession). Additionally, we noted seven instances of late payments ranging from 2 to 14 days. The noted exceptions, as a whole, resulted in approximately $27,802 in additional concession fees and interest. The auditor suggests recovery of this amount.

Schedule of Findings and Recommendations

1. Misclassified Gross Sales

Section 5 of the lease agreement defines Gross Sales subject to concession as follows:

> "…The term "gross sales" as used herein means the total selling price, fee or charge, whether for cash, credit or otherwise, of all prepared meals, food or other products, and of all related food catering services or other services, and all other receipts whatsoever, *resulting from all business conducted on or in the immediate vicinity of the Airport, regardless of delivery point or place of payment, …"*

The in-flight kitchen facilities where food services and preparation take place are owned by the Port and located on or in the immediate vicinity of Sea-Tac Airport. Flying Food is leasing these premises from the Port.

The lease agreement provides different rates for airline and non-airline sales under Amendment 2 as follows:

> "…Lessee shall pay to the Port during the full term or terms of this Lease, in addition to rental to be paid pursuant to paragraph 4, an amount equal to seven percent (7%) of "gross sales" (as that term is here in defined) to airlines…Lessee shall pay to the Port an amount equal to three and one-half percent (3 ½%) of gross sales to non-airlines parties…"

We noted Flying Food Services did not properly classify gross sales in accordance with the terms of the agreement. The misclassified gross sales resulted in additional concession fees of approximately $26,624 as follows:

	Type of Gross Sales	Reported Gross Sales	Actual Gross Sales per Audit	Rate	Total Concession Due	Total Paid	Additional Amount Due
2006*	Airline	13,247,515	13,461,304	7%	942,291	936,710	7,483
	Non-Airline	268,119	54,330	3.5%	1,902		
2007*	Airline	14,716,891	14,898,130	7%	1,042,869	1,039,981	6,343
	Non-Airline	279,963	98,723.64	3.5%	3,455		
2008	Airline	13,207,728	13,313,468	7%	931,943	929,713	3,685
	Non-Airline	146,860	41,563	3.5%	1,455		
2009	Airline	11,982,362	12,242,758	7%	856,993	849,096	9,113
	Non-Airline	295,149	34,752	3.5%	1,216		
						Grand Total	**26,624**

*We expanded the audit scope to 2006 and 2007 to capture the full extent of the misclassification.

Recommendation

We recommend management collect approximately $26,624 in additional concession fees for 2006, 2007, 2008, and 2009.

Management Response

Management will forward the audit findings to the tenant and ask them to respond within 30 days.

2. Untimely Payments

The agreement stipulates an interest charge of 18% per annum for payments not paid within 15 days following the end of each calendar month.

We noted nine instances of late payments ranging from 2 to 14 days. The late payments resulted in approximately $1,178 of interest charges.

Recommendation

We recommend management collect approximately $1,178 in financial interest charges, and/or work with the lessee to ensure timely payments.

Management Response

Aviation Business Development (AVBD) and Accounting & Financial Reporting (AFR) staff appreciate the insight provided by the internal audit regarding interest (finance) charges. The AFR department is continuing to seek opportunities to resolve longstanding challenges with the PeopleSoft financial system's shortcoming regarding applying finance charges on late payments, even though the impacts from this shortcoming are immaterial when taken as a whole. AVBD and AFR staff will address the audit's observations involving incompleteness in the application of finance charges and determine appropriate disposition involving the affected tenant