



To: Mark Reis, Managing Director Aviation
James Schone, Director Business Development & Management

From: Joyce Kirangi, CPA,
Director, Internal Audits

Date: December 17, 2009

Re: AV Business Development & Management Department

Internal Audit has completed an audit of the Business Development & Management Department. The audit covered the period January 1, 2007 through December 31, 2008. Our audit report contains no findings; however, during the course of the audit, we noted some internal control weaknesses that could be improved. The noted weaknesses were not significant enough to rise to the level of a finding; however, if these controls are not addressed, the weaknesses could develop into significant issues in the future.

The noted weaknesses involved: a lack of formalized risk assessment process, untimely processing and/or input of the lease agreement terms, and segregation of duties. This management letter is intended to assist you as you continue to improve internal controls and operational efficiency of your department

A. Risk Assessment

Through discussions with you and your senior managers, we determined that risk assessment is part of your normal process. You were able to articulate several risks facing your department as well as several key controls implemented to mitigate those risks to an acceptable level. The department does a good job of establishing holistic goals and objectives in line with the overall goals and objectives of the Port. You were able to articulate several risks facing your department as well as several key controls implemented to mitigate those risks to an acceptable level.

Your risk assessment procedures; however, appear to be rather informal and fragmented. A formalized Risk Assessment helps identify in advance those obstacles that can prevent your department from achieving its goals and objectives. Once you identify the risks, you can design and implement controls to mitigate those risks to an acceptable level. In essence, a formalized Risk Assessment helps management proactively manages its risks. Without a formalized Risk Assessment, management risks not being alerted when department objectives are in danger of not being achieved.

Recommendation

We recommend that management formalize its risk assessment process. Specifically we believe that the department should consider:

- Seek input from all levels of employees when identifying risks.
- Make risk identification and assessment a regular and ongoing process.
- Document and formalize the results of risk assessment discussions.
- Develop internal controls designed to mitigate each risk to an acceptable level, or complete an action plan to address each risk.



- Summarize the risk assessment procedures in a single Risk Assessment document.
- Continually revisit and reassess risks on an ongoing basis.

B. Untimely Processing of Agreement Information

1. Minimum Annual Guarantee (MAG) Increase Notification

The annual MAG increase is calculated based on a certain percentage of prior year concessionable revenue. We tested a sample of 36 MAG and holdover (month-to-month) notifications to establish whether Port management had notified the lessee timely. From our test, we noted five instances where more than 100 days had elapsed before the lessee was notified of the MAG change as follows:

Agreement #	Lessee	MAG Effective Date	Date POS Sent the Notification	# of Days Passed the Effective Date	Over 60 Days
629	Smart Cart	2/1/07	6/19/07	138	78
437	Airport Management	5/1/07	8/27/07	118	58
629	Smart Cart	2/1/08	5/13/08	102	42
923*	AT&T	1/1/06	1/2/08	731	571
923*	AT&T	1/1/07	1/2/08	366	306

Although expected payments were ultimately billed and collected in full, the Port did not receive the agree-upon MAG increase timely.

The timeline of the MAG notification is not just an incidental administrative responsibility. Rather, it has a direct financial impact. Delayed notifications result in late payments and as such represent lost opportunities to the Port to utilize that cash flow (i.e., interest). The foregone interest on the noted five exceptions is \$12,175 at an approximate interest rate of 2%/annum.

2. PROPWorks

PROPWorks is a comprehensive software package designed to manage lease and property at the Port. The Aviation Business Development & Management Department utilizes the system to manage lease agreements and relies heavily on the system to maintain and track all material lease provisions including, but not limited to, expiration date, renewal dates, and billing terms. Based on information entered into the PROPWorks system, Accounting and Financial Reporting (AFR) performs billing on a monthly basis.

We selected a sample of sixteen (16) agreements and tested them to establish whether lease term information was entered into PROPWorks timely. From our sample, we noted four (4) agreements that were not entered into PROPWorks timely. The auditor set a threshold of 14 days following execution of the lease as a reasonable period within which to administratively process the agreement and enter all the lease terms and information into PROPWorks.



Agreement #	Lessee	Lease Effective Date	Lease signed and Executed Date	Lease Terms entered into PROPWorks and Transmitted to Accounting	# of Days Late
941	Butter London, Inc	5/21/07	8/23/07	10/19/07	57
916	Highline Historical Society	2/1/07	12/7/06	3/5/07	88
953	Security Point Media	5/17/07	5/17/07	8/29/07	104
950	Clear Channel	8/1/07	7/19/07	10/15/07	88

Timely input into PROPWorks system is critical as it triggers subsequent processing including billings. Fully executed agreements will not be billed if the agreements do not exist in the PROPWorks system. Thus untimely input into PROPWorks inevitably leads to untimely billings which could have a cash flow financial impact to the Port.

Recommendation

We recommend that management strengthen existing controls to ensure timely MAG notifications and any necessary follow-up. If practical, establish a performance matrix as to when lease information should be fully entered into PROPWorks.

C. Segregation of Duties in PROPworks

Separation of duties is a necessary, not required, element of a sound internal control system. It prevents a single person from performing incompatible tasks from beginning to end. As such, it provides management with reasonable assurance over potential wrongdoing including fraud.

We observed that system access of one manager to PROPWorks is too concentrated. The manager could enter, edit, and/or delete any agreement information in the system. While there is a degree of management monitoring, the control is unlikely to be effective as the manager could easily circumvent the control (modify or delete after the fact).

Mere absence of separation of duties, in and of itself, is not an indication of inadequate controls. The absence could be unavoidable if available staff is not adequate. It should be recognized, however, that concentration of incompatible duties has numerous risks, and these risks must be subject to additional indirect controls to compensate for the absence.

Recommendation

We recommend that management expand its current monitoring role as a compensating control, if the segregation of duties is not operationally feasible.



Joyce,

The following is the AVBD management response to the audit.

First of all, I would like to express my appreciation to the Internal Audit staff for their thorough review of AV Business Development (AVBD) processes and procedures. Their work is important to validating both what we are doing well and where we need to improve.

In regards to the items listed in the Management Letter, I offer the following response.

A) Risk Assessment

The report states that the department's risk assessment procedures are rather informal and fragmented. When it comes to three of the most significant risks associated with our responsibilities, that of payment, surety and insurance from our tenants, our risk assessment procedures are quite formal and well-coordinated with all appropriate stakeholders throughout the organization. There are regular updates from Accounting staff on late payment issues. The AVBD Properties staff provides bi-weekly updates on all surety and insurance expiring that month with the relevant documentation of all communication with the tenants on these matters. And with the myriad other risks that develop at any given time that could impact airport business, there are well organized mechanisms for keeping senior management apprised of these matters.

I also recognize that we can always improve and need to learn from best practices for risk assessment. I understand that the organization has undertaken a risk assessment and management pilot project at Fisherman's Terminal. We look forward to studying the results of this pilot project when it is completed and incorporating any recommendations from that effort into our practices.

B) Untimely Processing of Agreement Information

1. Minimum Annual Guarantee (MAG) Increase Notification:
AVBD Lease Administration staff are now utilizing a program component within PROPworks to remind staff of when these recalculations are due. There are also monthly meetings with Accounting to review any problems that either group is encountering so that they can be addressed collaboratively.
2. PROPworks:
As lease agreements vary a great deal in complexity, the time needed to properly enter them into the PROPworks system also varies a great deal. I have asked the AVBD Lease Administration staff to create a tracking mechanism for all leases from start of negotiations to entry into the PROPworks system that will be reviewed monthly to ensure that staff are completing all necessary tasks in a timely fashion.

C) Separation of Duties with PROPWORCS

I agree with Internal Audit's recommendations regarding the need for separation of duties between those responsible for negotiating leases and those entering the lease information into the PROPworks system. However, given the cutbacks in AVBD staffing that occurred in 2009, my ability to completely eliminate this risk is limited without causing additional problems in other areas of the lease administration process.

Thank you for the opportunity to comment.

Sincerely,

Jim Schone

Director - Aviation Business Development

Seattle-Tacoma International Airport

Port of Seattle