



Internal Audit Report

Concessions International, LLC

Lease and Concession Compliance Audit

January 1, 2006 through December 31, 2008

Issue Date: February 09, 2010
Report No. 2010-05

Table of Contents

Internal Auditor’s Report.....	3
Executive Summary.....	4
Background.....	5
Audit Objectives	6
Audit Scope.....	6
Audit Approach.....	6
Conclusion	6
Schedule of Findings and Recommendations	7
1. Late Payments of Minimum Annual Guarantee and Percentage Fee	
2. Untimely and Incomplete Certified Annual Report of Gross Receipts	

Internal Auditor's Report

We have completed an audit of the Lease and Concession Agreement between the Port of Seattle and Concessions International, LLC (CI). 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 complies with applicable state and Port requirements.

We examined information related to a 3-year period from January 1, 2006 to December 31, 2008.

We conducted our audit using due professional care, and we planned and performed the audit to obtain reasonable assurance as to whether the Port and the lessee had complied with significant provisions of the agreement.

The agreement complied with applicable requirements. Other than for a minor exception, the lessee reported to the Port all concessionable Gross Receipts in accordance with the terms of the agreement. However, the lessee did not comply with the terms and provisions of the agreement related to timely remittance of concession payments. The untimely payments resulted in auditor's calculated penalty and interest of approximately \$76,896 for the audit period. We also noted non-compliance with the provision related to timely filing of the CPA Certified Annual Report of Gross Receipts.

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



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 complied with applicable state and Port requirements.

We examined the books and records of Concessions International, LLC in order to verify the accuracy and completeness of reported gross receipts and concession fees paid to the Port from January 1, 2006 through December 31, 2008. Aviation Business Development has the primary responsibility for administering and monitoring the agreement to ensure compliance with agreed-upon terms.

Agreement Terms Concessions International, LLC (CI) is an airport concessionaire of food and beverage operations at eight major U.S.A airports, including Sea-Tac Airport. At Sea-Tac, CI currently operates three Seattle's Best Coffee stores; one KOBO/Udon; two hamburger/grill fast food units; and one restaurant (Bigfoot Food & Spirits) which is operated by an ACDBE subtenant. According to the terms of the agreement, Concessions International, LLC shall pay to the Port for the concession rights and privileges granted as follows: the higher of the Minimum Annual Guarantee (MAG) of 90% of the total amount paid to the Port for the previous agreement year or a Percentage Fee by category as defined in the agreement. The MAG amount shall be divided into equal monthly payments. All monthly payments of MAG shall be payable in advance, on or before the first day of each month **without notice from the Port** and without setoff or deduction. To the extent the Percentage Fee as defined in the agreement is higher than the monthly payment of the MAG paid to the Port, lessee shall pay the Percentage Fee on or before the 15th of the following month.

Audit Result Summary The agreement complied with applicable state and Port requirements. Concessions International LLC reported all concessionable Gross Receipts to the Port except for a minor exception. However, it did not comply with the terms and provisions of the agreement related to timely remittance of MAG and Percentage Fee concession payments. The untimely payments resulted in auditor's calculated penalty and interest of approximately \$76,896 for the audit period. We also noted non-compliance with the provision related to timely filing of the CPA Certified Annual Report of Gross Receipts.

Internal Audit
Concession International, LLC, Agreement No. 438
Audit Period: January 1, 2006 – December 31, 2008

Background

Concessions International, LLC (CI) has been in business since 1979 and is currently headquartered in Atlanta, Georgia. It is a family and minority owned company with operations in eight major U.S.A. cities.

Under the terms of the agreement with the Port, the lessee agreed to pay a Minimum Annual Guarantee (MAG) or percentage fees of its gross receipts generated at the airport facility. The percentage concession fees range from 12% on branded food and beverage to 27% on souvenirs.

For the audit period the lessee operated and managed the following stores and subtenants:

- Stores: Three Seattle’s Best Coffee, one Runway Deli, and one Botanical (converted to KOBO in 2007)
- Subtenants: One non-ACDBE subtenant operating two Burger King Franchise Units and Dryer’s Ice Cream/See’s Candy (converted to Bigfoot Food & Spirits in mid-2008).

The lease agreement requires a Minimum Annual Guarantee (MAG) of 90% of the previous year Gross Receipts or percentage fees by category, whichever is higher as follows:

	2006	2007	2008*	
			Non-ACDBE	ACDBE
Non-Branded Food and Beverage (F&B)	14%	14%	13.50%	12 %
Branded F&B	12%	12%	11.50%	10 %
Alcohol Beverage	18%	18%	17.50%	16 %
Souvenir Merchandise	27%	27%	26.50%	25 %
Advertising and All Others	15%	15%	14.50%	13 %

*ACDBE stands for Airport Concessions Disadvantaged Business Enterprise.

In the past two agreement years, the Port received the following concession fees.

Description	2006	2007	2008
Concessionable Gross Receipts	\$6,135,792	\$6,517,726	\$7,571,341
Concession to the Port	\$767,532	\$812,807	\$948,238

Source: Lessee’s financial records and AFR (Accounting and Financial Reporting)

Aviation Business Development with the assistance from Accounting and Financial Reporting is responsible for administering and monitoring the agreement to ensure compliance with agreed-upon terms and conditions.

Audit Objectives

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 complies with applicable state and Port requirements.

Audit Scope

The scope of the audit covered the period of January 1, 2006 through December 31, 2008.

Audit Approach

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

- Obtained an understanding of the lease agreement.
- Identified significant provisions in the agreement to establish the extent of audit procedures.
- Obtained necessary financial and non-financial data from the lessee
- Analyzed data (internal & external) to determine completeness & compliance:
 - Reconciliation of the reported gross 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.
 - Recalculation of concession and related fees to ensure accuracy.

Conclusion

The agreement complied with applicable state and Port requirements. Concessions International LLC reported all concessionable Gross Receipts to the Port except for a minor exception. However, it did not comply with the terms and provisions of the agreement related to timely remittance of MAG and Percentage Fee concession payments. The untimely payments resulted in auditor's calculated penalty and interest of \$76,896 for the audit period. We also noted non-compliance with the provision related to timely filing of the CPA Certified Annual Report of Gross Receipts.

Schedule of Findings and Recommendations

1. Late Payments of Minimum Annual Guarantee and Percentage Fee

The agreement under Section 4 stipulates specific payment terms for concession fee and Minimum Annual Guarantee (MAG) payments as follows:

- MAG – payable in advance, on or by the first day of each and every month, without notice from the Port and without setoff or deduction.
- Percentage Fees – payable on or before the fifteen (15) day of each month.

For late payments, the agreement provides under Section 9 a penalty of 5% and interest to be accrued at 18% per annum or the maximum allowed by the law, whichever is less.

We reviewed payment history for the audit period and noted twenty (20) and ten (10) instances of late MAG and concession fee payments, respectively, as follows.

Year	Type of Payment	# of Instances of Late Payments	Range of Days Late	Late Charge (5%)	Interest (18%/yr)	Grand Total
2006	MAG	5	1 to 11	\$14,519	\$516	\$15,034
	Concession	3	22 to 36	\$1,163	\$337	\$1,501
2007	MAG	6	1 to 51	\$17,463	\$1,981	\$19,443
	Concession	2	2 to 6	\$1,706	\$53	\$1,759
2008	MAG	9	1 to 19	\$27,668	\$1,607	\$29,275
	Concession	5	3 to 62	\$8,630	\$1,254	\$9,884
				\$71,149	\$5,747	\$76,896

Based on the 5% one-time penalty for overdue payments plus interest of 18% until paid, our calculation resulted in penalty and interest charges of approximately \$76,896 for the period January 1, 2006 through December 31, 2008.

Recommendation

We recommend management bill Concessions International, LLC approximately \$76,896 in penalty and interest.

Management Response

The audit documented instances when Concessions International submitted Minimum Annual Guarantee (MAG) and Percentage Fee payments late. The lease agreement stipulates a 5% penalty and interest accrued at 18% per annum. AFR bills the predetermined monthly MAG amount for payment. Concessionaires pay percentage fee payments when gross sales are reported, up to 15-20

Internal Audit
Concession International, LLC, Agreement No. 438
Audit Period: January 1, 2006 – December 31, 2008

days after the conclusion of a sales month. These percentage fee amounts are variable depending upon sales.

The Port's central financial system does not provide an automated mechanism to bill tenants the 5% penalty for late payment. In June 2009, the Port put in place a manual solution using a desktop application to compute penalty fees. With this tool in place, all tenants were notified that moving forward they would be billed penalty for late payments. All tenants are now being billed for any applicable late penalties according to the terms of their lease.

Management is working toward resolution of the issue of retroactive late penalties and interest for revenue prior to mid-2009, in consultation with Port Legal counsel.

2. Untimely and Incomplete Certified Annual Report of Gross Receipts

Under Section 7 of the agreement, the lessee is required to provide the Port with a certified Schedule of Gross Receipts for each calendar year within sixty (60) days after the close of each agreement year. The schedule is required to be certified by the Chief Financial Officer (CFO) and accompanied by a signed certificate of an independent Certified Public Accountant (CPA). The CPA certification is required to include, among many, reasonable assurance that the reported gross receipts are complete and conform to the definition of gross receipts in the agreement.

We noted the schedule for the audit period was untimely and incomplete as follows.

Year	Report Received	# of Days Late	Other Noncompliance
2006	September 2009	912	The CPA certification did not include concessionable gross receipts of the lessee's subtenants for all three years.
2007	September 2009	577	
2008	May 2009	80	

Timely and independently certified gross receipts are a significant part of a complete lease management system. It is a mechanism designed to compensate, to a degree, an inherent risk of self-interest in a self-reporting system.

Recommendation

We recommend management strengthen the existing monitoring system to ensure complete and timely filing of the Certified Annual Report of Gross Receipts in compliance with the terms of the agreement.

Management Response

The audit documented that Concessions International did not provide the Port with a certified Schedule of Gross Receipts within 60 days after the end of the agreement year, for all three years of the audit period. The CPA certification also failed to include the gross receipts of the Burger King franchisee subtenant, which is without question a consequence of the relationship with this subtenant. The issues with the subtenant may have also had bearing on CI's timely reporting of annual audited sales, nonetheless a requirement of the lease.

A new provision has been added to the Port's lease management system (PropWorks) to track the timely submittal of the audited report. This will provide an increased quality control mechanism for the AFR staff that receive the audited reports from all tenants.