INTERNAL AUDIT REPORT

SLOA III Airline Agreement

Compliance with Calculation of Rates and Charges

Limited Operational Audit

January 1, 2013 – December 31, 2014

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TABLE OF CONTENTS

TRANSMITTAL LETTER

Audit Committee
Port of Seattle
Seattle, Washington

We have completed an audit of SLOA III – Compliance with Calculation of Rates and Charges. We reviewed information for the period January 1, 2013 – December 31, 2014.

We conducted this performance audit 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 perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We extend our appreciation to the management and staff of the Aviation Finance and Budget (F&B) Department for their assistance and cooperation during the audit.

Kirangi

Joyce Kirangi, CPA, CGMA
Internal Audit, Director

AUDIT TEAM	RESPONSIBLE MANAGEMENT TEAM
Brian Nancekivell, Senior Auditor	Borgan Anderson, Director, Aviation F&B
Margaret Songtantaruk, Senior Auditor Jack Hutchinson, Manager	Hahn Nguyen, Manager, Aviation F&B

EXECUTIVE SUMMARY

AUDIT OBJECTIVES AND SCOPE

The purpose of the audit was to determine whether management controls are adequate to ensure:

- Rates charged are accurate and in accordance with the agreement terms and conditions (2013 actual and 2014 budget).
- The 2013 year-end airline reconciliation and settlement, including revenue sharing, was accurate and in accordance with the agreement terms and conditions.

We reviewed information for the period January 1, 2013 – December 31, 2014. Details of our audit's scope and methodology are on page 6.

BACKGROUND

The Signatory Lease and Operating Agreement (SLOA III) is a five-year agreement between the Port and the airlines. The agreement defines the rights and privileges of occupancy and use of the airport. It was the result of long and complex negotiations with the airlines, starting in early 2011, and culminating in final approval and acceptance in late 2013. The terms of the agreement were retroactive to January 1, 2013.

During the negotiations, the existing agreement (SLOA II) was extended to 2012. Its rates were used for billing purposes for January - July 2013. The Port used the rates in Resolution 3677 (set by the Commission under FAA/DOT policy) for August - December 2013. Actual SLOA III rates were used for rebilling airlines for 2013 retroactively.

Rates are calculated based on the SLOA III terms and conditions, which provide greater transparency and detail. Rates are based on a cost recovery methodology, plus:

- Activity (e.g., landings, gates, baggage, passengers, ticket counters).
- Space (e.g., baggage make up, terminal and office space).
- Fixed (e.g., preferential gates, baggage make up percentage, bag claim charge percentage).

AUDIT RESULT

Management controls are adequate to ensure that the rates charged for 2013 actual and 2014 budget and the 2013 year-end airline reconciliation and settlement, including revenue sharing, were accurate and in accordance with the agreement terms and conditions.

BACKGROUND

The Signatory Lease and Operating Agreement (SLOA III) is a five-year agreement between the Port and the airlines. The agreement defines the rights and privileges of occupancy and use of the airport. It was the result of long and complex negotiations with the airlines, starting in early 2011 and culminating in final approval and acceptance in late 2013. The terms of the agreement were retroactive to January 1, 2013.

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Some key changes of SLOA III:

- Capital costs of aeronautical assets –the time period expanded from 2006 to 1992; amortization calculated using borrowing costs in year asset placed in service.
- Revenue sharing - new - at 50% after meeting 125% of annual debt service.
- Space - more transparent costing; Port assumes cost of vacant space.
- Airfield - from 1 to 3 cost centers.
- Baggage make up[1] - more complex calculation.
- Federal Inspection Service (FIS) - separate cost center.
- Space weighting – changed percentages.
- Gates - different cost recovery method.
- Year-end reconciliation - for each cost center.

SLOA III rates and charges were implemented primarily by three departments:

- Aviation Finance & Budget - calculated estimated and actual rates; performed year end reconciliation.
- Aviation Business Development (Properties group) - input rates into PROPworks for billing purposes; provided details of estimated and actual activity & space utilization.
- Accounting and Financial Reporting - set up new cost centers; prepared actual billings.
- Others involved:
  - Corporate Finance & Budget - for data on debt service.
  - Aviation Operations - for data on airlines activity.
  - Airlines - self-reporting activity.

Rates are calculated based on the SLOA III terms and conditions, which provide greater transparency and detail. Rates are based on a cost recovery methodology, plus:

- Activity (e.g., landings, gates, baggage, passengers, ticket counters).
- Space (e.g., baggage make up, terminal and office space)
- Fixed (e.g., preferential gates, baggage make up percentage, baggage claim charge percentage)

[1] Baggage Make Up includes the spaces and devices for sorting and transporting outbound baggage.

Estimated rates are based on the following year's budgeted capital costs, operating expenses, and expected activity by the airlines (e.g., number and type of flights, number of passengers, baggage, and use of space).

Actual rates are recalculated based on actual capital costs, operating expenses, airline activity, and space use.

FINANCIAL HIGHLIGHTS

SLOA III REVENUE (in thousands)

	2013		2014	
	Actual	**% of Total**	**Budget**	**% of Total**
Landing Fees	$ 69,679	32%	$ 74,590	31%
Ramp Tower Fees	1,006	0.5%	1,119	0.5%
Apron Fees	6,158	3%	8,000	3%
Terminal Rentals				
Preferential Leased Gate Charges	56,969		56,755	
Common Use Baggage Make-Up (BMU) Fees	20,006		21,245	
Baggage Claim Fees	14,990		18,034	
Public-Access. Office Rents	10,720		12,361	
Non-Public-Access. Office Rents	7,988		9,612	
Common Use Gate Fees	7,310		6,407	
Baggage Make-Up (BMU) Preferential. Space Rents	6,533		7,419	
Other (ticket counter, space rents, loading bridge fees, etc.)	10,305		12,559	
Total Terminal Rentals	134,821	61%	144,392	61%
Federal Inspection Services (FIS) Fees	7,525	3%	8,618	4%
Remaining Overnight (RON) Fees	745	0.5%	1,095	0.5%
Open Storage Space Rents	189	0%	249	0%
Total	$ 220,123		$ 238,063	
OTHER ADJUSTMENTS				
Revenue Sharing	(9,773)		(6,136)	
Leasehold Tax	274			
NET REVENUE	$ 210,624		$ 231,927	

Data Source: Aviation F&B

HIGHLIGHTS AND ACCOMPLISHMENETS

During the course of the audit, we noted the following highlights and accomplishments. The Department:

- Implemented numerous complex rate calculations.
- Performed year-end settlement on schedule.
- Accomplished myriad tasks within a compressed time frame.

AUDIT SCOPE AND METHODOLOGY

We reviewed information for the period January 1, 2013 – December 31, 2014. We utilized a risk-based approach from planning to testing. We focused on Article 8 – Calculation of Rates and Charges – as the highest risk section of the agreement. We gathered information through research, interviews, observations, and data analysis, in order to obtain a complete understanding of the applicable terms and conditions. We assessed significant risks and identified controls to mitigate those risks. We evaluated whether the controls were functioning as intended.

We applied additional detailed audit procedures to areas with the highest likelihood of significant negative impact as follows:

1. To determine whether management controls are adequate to ensure rates charged are accurate and in accordance with the agreement terms and conditions.

   For the 2013 actual and 2014 budget rates, we tested the calculation methods for the following rates, which account for about 88% of total SLOA revenue:

   - Landing fees.
   - Gate rates and fees – preferential and common use.
   - Baggage claim rate.
   - Baggage make up system space rate and fees.
   - Baggage make up system fees.
   - Terminal rental rates for Group A (gates), Group B (ticket counters, baggage claim, baggage make up, publicly-accessible offices, security checkpoint areas and VIP lounges) and Group C (non-publicly-accessible offices).

   We reviewed the management process for checking and verifying the accuracy of rate calculations.

   We verified that the rate calculation methods agreed with the agreement terms and conditions.

   We reviewed the calculation of allocable capital costs by rate category. We reviewed the debt service and amortization models used to allocate capital costs. We traced debt service costs to the source data from Corporate Finance.

We traced allocable operating and maintenance expenses by rate category to source data from PeopleSoft and reconciled to cost center reports.

We traced airline activity data used in the various rate calculations to applicable source data from Properties.

2. To determine whether the 2013 year-end airline reconciliation and settlement, including revenue sharing, was accurate and in accordance with the agreement terms and conditions:

   We traced approved billing rates to tariff, to PROPworks billing rule, and to PeopleSoft invoicing. We reviewed management's process for gathering information from various sources and observed staff entering information into PROPworks and PeopleSoft.

   We reconciled and validated approximately 37% the allocated costs of landing fees and common use airlines payments.

   We recalculated and validated the year-end true up.

   We recalculated and validated the revenue sharing for the top 6 of 33 signatory airlines.

CONCLUSION

Management controls are adequate to ensure that the rates charged for 2013 actual and 2014 budget and the 2013 year-end airline reconciliation and settlement, including revenue sharing, were accurate and in accordance with the agreement terms and conditions.