INTERNAL AUDIT REPORT

FLYING FOOD GROUP, LLC
LEASE AND CONCESSION AGREEMENT

JANUARY 1, 2011 – DECEMBER 31, 2013

ISSUE DATE: MAY 7, 2015
REPORT NO. 2015-05

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TRANSMITTAL LETTER

Audit Committee
Port of Seattle
Seattle, Washington

We have completed an audit of Flying Food Group, LLC, Lease and Concession Agreement. We reviewed information for the period January 1, 2011 – December 31, 2013.

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 Business Development Department and Accounting and Financial Reporting for their assistance and cooperation during the audit.

Joyce Kirangi, CPA, CGMA
Internal Audit, Director

AUDIT TEAM	RESPONSIBLE MANAGEMENT TEAM
Jack Hutchinson, Audit Manager	Jim Schone, Director, Aviation Business Development
Ruth Riddle, Senior Auditor	James Jennings, Manager, Aviation Properties
	Rudy Caluza, Director, Accounting and Financial Reporting

EXECUTIVE SUMMARY

AUDIT OBJECTIVES AND SCOPE

The purpose of the audit was to determine whether:

1. The reported concession fees were complete, properly calculated, and remitted timely to the Port.
2. The lessee complied with significant provisions of the Lease and Concession Agreement, as amended.

We reviewed information for the period January 1, 2011 – December 31, 2013. Details of the audit scope and methodology are on pages 5 and 6.

BACKGROUND

Flying Food Group, LLC, (FFG) was founded in Chicago in 1983, at which time it served one airline out of one kitchen at Midway Airport. Today, FFG produces over 100 million meals annually from its network of 18 US kitchens, which stretch from Honolulu to New York City. Customers include over 70 of the world's leading airline customers—primarily international—plus key retail partners, including over 3,000 US Starbucks.

The agreement with the Port of Seattle originated in 1988. It spans a term of 30 years. At the end of the lease term in 2018, there is provision for two, five-year options, at the Port's discretion. The agreement requires a monthly concession payment of 7% of gross sales.

AUDIT RESULT

The reported concession fees were materially complete, properly calculated, and remitted timely to the Port. The lessee materially complied with significant provisions of the Lease and Concession Agreement, as amended, except for failing to meet the required timeline for submission of the annual report (Finding 1).

BACKGROUND

Flying Food Group, LLC, (FFG) was founded in Chicago in 1983, at which time it served one airline out of one kitchen at Midway Airport. Today, FFG produces over 100 million meals annually from its network of 18 US kitchens, which stretch from Honolulu to New York City. Customers include over 70 of the world's leading airline customers—primarily international—plus key retail partners, including over 3,000 US Starbucks.

The agreement with the Port of Seattle originated in 1988. It spans a term of 30 years. At the end of the lease term in 2018, there is provision for two, five-year options, at the Port's discretion. The agreement, as amended, requires a monthly concession payment of 7% of gross sales.[1]

Flying Food Group is known for airline passenger meals in a wide variety of cuisines, including American, Chinese, French, German, Halal, Italian, Indian, Japanese, Korean, Malaysian, Thai, and Turkish.

The company produces over 300,000 in-flight meals and snacks daily for airline customers—primarily international—and non-airline catering retail partners.

FINANCIAL HIGHLIGHTS

KEY FINANCIAL RESULTS FOR FLYING FOOD GROUP

AGREEMENT YEAR	REPORTED GROSS SALES	CONCESSION PAID
2011[2]	$ 12,670,003	$ 859,683
2012	13,056,391	913,947
2013	12,776,481	894,353
TOTAL	**$ 38,502,875**	**$ 2,667,983**

Data Source: PeopleSoft Financials

AUDIT SCOPE AND METHODOLOGY

We reviewed information for the period January 1, 2011 – December 31, 2013. We utilized a risk-based audit approach from planning to testing. We gathered information through document review, inquiries of the lessee, observations, and data analysis, in order to obtain a complete understanding of the financial requirements of the agreement between the Port of Seattle and FFG.

[1] Subsequent to a prior audit, FFG and the Port negotiated a settlement agreement, which eliminated the 3.5% concession fee on sales to airlines outside of Sea-Tac International Airport. Effective January 1, 2012, all sales to airlines (at Sea-Tac or elsewhere in the vicinity) were subject to the 7% fee.

[2] The sales subject to the 3.5% fee totaled $777,607. The concession fee on these sales totaled $27,216.

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

1. To determine whether the reported gross sales/concession fees were complete, properly calculated, and remitted timely to the Port.

    - Gross Sales/concession fees complete and properly calculated:
        - Reviewed the lessee's chart of accounts to determine whether all revenue accounts were reported.
        - Reconciled the following documents/reports provided by lessee:
            - Audited amounts from lessee's CPA
            - General Ledger
            - Sales Tax Reports
            - Monthly self-report of gross revenues and calculation of concession fee due.
        - Based on risk indicators -- concession fees decreased while enplanements increased -- we conducted detailed tests of the following months (selecting at least one billing per customer):
            - June, August 2011
            - December 2012
            - March 2013

          We determined whether:
            - Customer billings agreed to customer orders.
            - Amounts billed and discounts granted agreed to the receipts.
        - Quantified and tested a sample of discounts recorded to the General Ledger
    - Late fees and interest assessed and paid:
        - Reviewed all payment records for the audit period to determine whether payments were received timely.
        - Identified late payments, if any, calculated late fees/interest, and determined whether billed and paid.

2. To determine whether the lessee complied with significant provisions of the Lease and Concession Agreement, as amended, we determined whether lessee:
        - Submitted certified reports by required date.
        - Maintained required insurance at specified amounts.
        - Maintained corporate surety bond (or other security) at specified amount.

CONCLUSION

The reported concession fees were materially complete, properly calculated, and remitted timely to the Port. The lessee materially complied with significant provisions of the Lease and Concession Agreement, as amended, except for failing to meet the required timeline for submission of the annual report (Finding 1).

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

1. FLYING FOOD GROUP, LLC, DID NOT SUBMIT THE ANNUAL REPORT BY THE DUE DATE.

Section 7 of the lease and concession agreement states:

> *Within a period of sixty (60) days following the end of each calendar year or portion thereof during the term of this Lease and concession Agreement, Lessee shall deliver to the Port a statement of the concession fees due under paragraph 5 for the calendar year or portion thereof. Lessee's statement shall be prepared with reasonable detail and certified by a Certified Public Accountant engaged by Lessee for this purpose.*

During the period under audit, the lessee did not submit the annual reports within the 60 days required by the agreement. The annual audit of Flying Food was not completed in time to meet this due date.

The annual report was submitted on the following dates:

SCHEDULE OF FLYING FOOD GROUP'S ANNUAL REPORT SUBMISSIONS

YEAR	DUE DATE	DATE OF CPA REPORT
2011	02-28-12	04-30-12
2012	02-28-13	06-04-13
2013	02-28-14	04-04-14

The Port uses the CPA's annual reports to adjust the amounts previously reported by the lessee in its monthly reports. The 60-day time frame ensures that any amounts due from or due to the lessee are properly accounted for in the Port's year-end financial statements. Although the adjustments were not significant, they could not be made until approximately six months after year-end.

Recommendations

We recommend Port management:

1. Discuss the annual report due date requirement with the lessee.
2. Amend the agreement language, as deemed necessary.

Management Response

The Port's Accounting & Financial Reporting (AFR) Department has a specific protocol in place regarding Certified Annual Reports that are to be provided by tenants. This protocol involves:

1) AFR sends a letter to the tenant reminding them of the due date for the Certified Annual Report.

2) If the tenant does not meet that deadline, AFR staff then send a past due notice to the tenant.

In both cases, this communication from AFR is reviewed with the appropriate AV Division Properties staff prior to sending to the tenant. These letters are kept in AFR's lease file.

3) Certified Annual Reports that are past due are also included as agenda items in regular monthly meetings that involve AFR and AV Division Properties staff to ensure that appropriate visibility is created to remind the tenant of their lease obligation.

In the case of Flying Foods, AFR followed the protocol identified above. And the annual report due date requirement was discussed with the tenant.

The only enforcement mechanism in the lease is to put the tenant in default. AV Properties staff will work with POS Legal staff to explore other means to enforce compliance with lease provisions short of putting a tenant in default.