

INTERNAL AUDIT REPORT

LIMITED CONTRACT COMPLIANCE
BEECHER'S HANDMADE CHEESE

JANUARY 2014 – DECEMBER 2017

ISSUE DATE: May 3, 2018

REPORT NO. 2018-01

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EXECUTIVE SUMMARY

Internal Audit (IA) completed an audit of the Lease and Concession Agreement (Agreement) between Beecher's Handmade Cheese (Beecher's) and the Port of Seattle (Port) for the period January 1, 2014 through December 31, 2017. The audit was performed to verify compliance with key terms in the Agreement, including the completeness and accuracy of concession fees paid to the Port.

The original Agreement between Beecher's and the Port was executed April 3, 2012, for the right to operate a food and beverage concession at the Airport. The Agreement required the Lessee to pay the Port a Minimum Annual Guarantee (MAG) equal to eighty-five percent (85%) of the total amount paid by the Lessee for the previous year.

We concluded that surety and street pricing requirements were achieved. However, we identified one medium rated issue, related to assessing the accuracy of revenue. This issue is discussed in more detail on page six.

- 1) The Agreement requires the Lessee, in part, to maintain records for a period of three years. However, the daily point of sale data was not provided to Internal Audit in its original format; rather, an excel document was provided. Cash register z-tapes, in their original format, are necessary to obtain reasonable assurance to conclude on the accuracy of concession revenue.

We extend our appreciation to Port management and staff of the Aviation Commercial Management Department for their assistance and cooperation during the audit.



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Director, Internal Audit

RESPONSIBLE MANAGEMENT TEAM

Lance Lyttle, Managing Director Aviation

Jim Schone, Director, Aviation Commercial Management

Dawn Hunter, Senior Manager, Airport Dining and Retail

Khalia Moore, Senior Business Manager, Airport Dining and Retail

BACKGROUND

Beecher's Handmade Cheese (Beecher's) is headquartered in Seattle and operates four cafés offering an assortment of fresh sandwiches, soups, salads, and cheeses. Beecher's has three locations in the Seattle area and one location in New York.

The original Agreement between Beecher's and the Port was executed April 3, 2012 for the right to operate a food and beverage concession at the Airport. The Agreement required the Lessee to pay the Port a Minimum Annual Guarantee (MAG) equal to eighty-five percent (85%) of the total amount paid by the Lessee for the previous year.

In addition to the MAG, the Agreement required the Lessee to pay a twelve percent (12%) concession fee, to the extent the percentage fee was higher than the monthly MAG payment. Beecher's is required to provide the Port with detailed statements of gross sales for the preceding month and a certified annual statement, of monthly gross sales, at the end of each year. The concession revenues from Beecher's have consistently exceeded the MAG.

The table below reflects the total concession revenue earned by the Port through the audit period.

BEECHER'S HANDMADE CHEESE		
Year	Gross Sales	Concession Revenue
2014	\$3,712,924	\$445,551
2015	4,461,175	535,341
2016	5,748,587	689,831
2017	6,903,741	828,449
TOTAL	\$20,826,427	\$2,499,172

* Data Source: PROPworks

The agreement also states that, at the Airport, the Lessee shall not charge prices for any menu items, products or services that exceed "Street Prices". Street prices are prices charged by companies with the same trade name, commonly recognized by the public.

AUDIT SCOPE AND METHODOLOGY

We conducted this 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.

The period audited was January 2014 – December 2017. After identifying significant provisions in the Agreement, we performed the following audit procedures:

Revenue Completeness and Accuracy

- Daily sales detail (z-tapes) were not available for most of the audit timeframe, accordingly, when not available, we agreed the provided Excel spreadsheet to the monthly profit and loss sales report, and to the general ledger.
- Agreed recalculated concession fees to amounts reported to the Port.
- Verified the accuracy of the concession fee by agreeing the percentage rate applied to the revenue category and agreeing to the fees invoiced.
- Obtained and reviewed documentation supporting the tenant's annual certification of gross sales.
- Agreed provided sales data to monthly bank statements. Certain information on Beecher's bank statements was redacted, thereby preventing us from obtaining sufficient assurance from this procedure.

Surety Deposit

- Recalculated annual surety deposits per the lease agreement.
- Validated that surety deposits were received timely, at the beginning of each lease year.

Street Pricing

- Obtained 2017 street pricing documentation.
- Discussed street pricing analysis with the Airport Dining and Retail department.
- Agreed airport prices to the Pike Place Market location to verify 'street pricing' compliance.

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

1) RATING: MEDIUM

The Agreement requires the Lessee, in part, to maintain records for a period of three years. However, the daily point of sale data was not provided to Internal Audit in its original format; rather, an excel document was provided. Cash register z-tapes, in their original format, are necessary to obtain reasonable assurance to conclude on the accuracy of concession revenue.

In the fourth quarter of 2017, Beecher's implemented a new point of sale system. Subsequent to the implementation, Beecher's did maintain original sales data. This allowed Internal Audit to successfully perform revenue validation procedures for the month of November 2017. This additional step provided us with reasonable assurance that revenue was accurately reported for the fourth quarter of 2017.

For the period prior to implementation, Beecher's did not retain the original receipt data to evidence their daily sales. Excel reports that display information, although unlikely, can be manipulated or can inadvertently remove data, thus compromising the completeness and accuracy of the report. Therefore, relying on reports that capture information downloaded from another source does not provide the same level of assurance as does obtaining source data in its original form.

Section 7.1 of the Agreement also reflects that the Lessee will establish and maintain an accounting system, including all books of accounts and records, that are "reasonably satisfactory to the Port for the determination of any Rent or other computations, or both, which may be necessary or essential in carrying out the terms of this Agreement...for a period of at least three (3) years."

This position is also consistent with the Internal Revenue Service record retention guidance, which requires cash register z-tapes and detailed x-tapes to perform their examinations.

Recommendation

Incorporate specific language into future Agreements that explicitly requires the original daily cash register data (z-tapes or x-tapes).

ADR management also suggested they would proactively communicate with Beecher's, and more broadly, all airport concessionaire's, the importance of maintaining original source data.

Management Response/Action

Due to unusual circumstances, Beecher's was unable to provide original documentation to support their reported sales. While the documentation was not in its original format as required, Beecher's did go to extensive measures to provide backup documentation to support the numbers provided to the Port. Additionally, there were no major discrepancies between what was submitted in previous years and what was able to be verified by the Port. Airport Dining and Retail staff has communicated with Beecher's senior management about the requirement in their lease to provide sales documentation in its original format and have requested that they provide that documentation along with their 2018 certified annual sales report.

DUE DATE: 12/31/2018

APPENDIX A: RISK RATINGS

Findings identified during the course of the audit are assigned a risk rating, as outlined in the table below. The risk rating is based on the financial, operational, compliance or reputational impact the issue identified has on the Port. Items deemed “Low Risk” will be considered “Exit Items” and will not be brought to the final report.

Rating	Financial	Internal Controls	Compliance	Public	Port Commission/ Management
HIGH	Large financial impact Remiss in responsibilities of being a custodian of public trust	Missing, or inadequate key internal controls	Noncompliance with applicable Federal, State, and Local Laws, or Port Policies	High probability for external audit issues and/or negative public perception	Important Requires immediate attention
MEDIUM	Moderate financial impact	Partial controls Not adequate to identify noncompliance or misappropriation timely	Inconsistent compliance with Federal, State, and Local Laws, or Port Policies	Potential for external audit issues and/or negative public perception	Relatively important May or may not require immediate attention
LOW/ Exit Items	Low financial impact	Internal controls in place but not consistently efficient or effective Implementing/enhancing controls could prevent future problems	Generally complies with Federal, State and Local Laws or Port Policies, but some minor discrepancies exist	Low probability for external audit issues and/or negative public perception	Lower significance May not require immediate attention
Efficiency Opportunity	An efficiency opportunity is where controls are functioning as intended; however, a modification would make the process more efficient				