



INTERNAL AUDIT REPORT

LIMITED CONTRACT COMPLIANCE
SKY CHEFS, INC.

MARCH 2015 – FEBRUARY 2017

ISSUE DATE: MAY 30, 2018
REPORT NO. 2018-06

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EXECUTIVE SUMMARY

Internal Audit completed an audit of the Lease and Concession Agreement (Agreement) between the Port of Seattle (Port) and Sky Chefs, Inc. (Sky Chefs or Lessee) for the period March 1, 2015 through February 28, 2017. The audit was performed to verify compliance with key lease provisions in the Agreement, including the completeness and accuracy of concession fees paid to the Port.

On September 26, 2014, the Port entered into the Agreement with Sky Chefs. Sky Chefs is the brand name of LSG Lufthansa Service Holding AG, which is the world's largest provider of airline catering and in-flight services, operating in 56 countries. It is a subsidiary of Deutsche Lufthansa AG. Sky Chefs prepares and delivers meals, beverages, and snacks for domestic and international flights.

The initial term of the Agreement was three years, commencing on March 1, 2014. Sky Chefs exercised the option to extend the lease term to February 28, 2019, two consecutive periods past the original lease expiration.

We concluded that the Lessee materially complied with the significant terms in the Agreement.

No issues were identified requiring management response.

We extend our appreciation to Port management, the staff of Aviation Business Development, and to Sky Chefs, Inc. for their assistance and cooperation during the audit.



Glenn Fernandes, CPA
Director, Internal Audit

RESPONSIBLE MANAGEMENT TEAM

Lance Lyttle, Managing Director Aviation

Jim Schone, Director, Aviation Business Development

James Jennings, Sr. Manager, AV Properties Group

BACKGROUND

LSG Lufthansa Service Holding AG is headquartered in Germany, while its North American headquarters are located in Irving, Texas.

The current Agreement (number AIR001849) between Sky Chefs and the Port became effective on March 1, 2014 for an initial term of three years. Sky Chefs provides in-flight catering service, including the preparation and distribution of in-flight foods, beverages, and related services to domestic and international flights out of Seattle Tacoma International Airport.

For the concession rights and privileges, the Lessee pays a monthly concession fee equal to 7% of gross revenue from Airport Operations and 3.5% of gross revenue from Off-Airport Operations. Off-Airport Operations include revenues arising from occasional charter activity at Joint Base Lewis-McChord, Boeing Field, Snohomish County Airport, and Bellingham International Airport.

The agreement also requires Sky Chefs to pay land and building rent. Rent is based on square footage and is due monthly. Land rent is \$14,966 per month and building rent is \$25,307 per month.

The table below reflects total concession revenue and land & building rent earned by the Port:

| SKY CHEFS, INC. | | | |
|------------------------|-----------------------|---------------------------|---------------------------------|
| Fiscal Year | Gross Revenues | Concession Revenue | Land & Building Rent |
| 2015 | \$49,032,636 | \$3,428,844 | \$483,268 |
| 2016 | 51,612,608 | 3,611,374 | 483,268 |
| TOTAL | \$100,645,244 | \$7,040,218 | \$966,536 |

* Data Source: PeopleSoft Financials

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 March 2015 through February 2017. After identifying significant provisions in the Agreement, we performed the following audit procedures:

Revenue Completeness and Accuracy:

- Agreed the data spreadsheets provided by Lessee to the monthly profit and loss sales report and to the General Ledger.
- Agreed the recalculated concession fees to amounts reported to the Port.
- Verified the accuracy of the concession fees by agreeing the percentage rate applied to the revenue category and fees invoiced.
- Obtained and reviewed documentation supporting the Lessee's Annual Certification of Gross Sales.
- Analyzed deductions in the data sheets to determine whether they were properly classified and correctly deducted from the gross revenues.
- Tested a judgmental selection of 30 invoices from high revenue volume months (15 selections from July 2015 and 15 from December 2016). Determined if the amounts on the revenue detail reports agreed to the amounts invoiced and reflected on bank statements.
- Obtained third party confirmations and from Alaska Airlines for invoices totaling \$5,114,486.

Surety Deposit:

- Recalculated annual deposits and validated that they were received timely.

Land & Building Rents:

- Reviewed the PeopleSoft Query results showing the monthly Land & Building Rent, invoiced to and paid by Sky Chefs, to the Port.
- Traced ACH payments to bank statements, to validate timeliness of payments.

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 | | | | |