



O R A N G E C O U N T Y

AUDITOR-CONTROLLER

I N T E R N A L A U D I T

**REVENUE GENERATING
LEASE AUDIT:**

**JOHN WAYNE AIRPORT -
ASFOUR FAMILY
CORPORATION dba SUBWAY**

**For the Period
December 1, 2014 through
November 30, 2015**



**Audit Number 1580
Report Date: April 29, 2016**



O R A N G E C O U N T Y
AUDITOR-CONTROLLER
I N T E R N A L A U D I T

Eric H. Woolery, CPA
Orange County Auditor-Controller

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ERIC H. WOOLERY, CPA
AUDITOR-CONTROLLER



Transmittal Letter

Audit No. 1580

April 29, 2016

TO: Barry A. Rondinella, Airport Director
John Wayne Airport

SUBJECT: Revenue Generating Lease Audit:
John Wayne Airport – Asfour Family Corporation
dba Subway, PM 1121-360-132, 132.1

We have completed our Revenue Generating Lease Audit of Asfour Family Corporation dba Subway for the period December 1, 2014 through November 30, 2015. Our final report is attached for your review.

I submit an **Audit Status Report** quarterly to the Audit Oversight Committee (AOC) and a monthly report to the Board of Supervisors (BOS) where I detail any critical and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the AOC and BOS.

Additionally, we will request your department to complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

A handwritten signature in blue ink, appearing to read "Toni Smart".

Toni Smart, CPA, Director
Auditor-Controller Internal Audit Division

Attachments

Other recipients of this report:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Eric H. Woolery, Auditor-Controller
- Frank Kim, County Executive Officer
- Mark Denny, Chief Operating Officer
- Jessica Witt, Deputy Chief Operating Officer
- Courtney Wiercioch, Assistant Airport Director, John Wayne Airport
- Ralph Sanchez, Deputy Airport Director of Business Development, John Wayne Airport
- Barbara Swift, Manager, John Wayne Airport Business Development
- Jessica Dixon, Real Property Agent, John Wayne Airport Business Development
- Mariane Teschner, Deputy Airport Director of Finance & Administration, John Wayne Airport
- Tonya Riley, Director, Satellite Accounting Operations, Auditor-Controller
- Vivienne Thornton, Accounting Manager II, John Wayne Airport Accounting Operations
- Jessie Zhu, Accounting Manager I, John Wayne Airport Accounting Operations
- Kenneth Wong, Administrative Manager II, John Wayne Airport Assurance & Compliance
- Foreperson, Grand Jury
- Robin Stieler, Clerk of the Board of Supervisors
- Macias Gini & O'Connell LLP, County External Auditor



Table of Contents

*Revenue Generating Lease Audit:
John Wayne Airport
Asfour Family Corporation dba Subway
Audit No. 1580*

For the Period December 1, 2014 through November 30, 2015

Transmittal Letter	i
Internal Auditor's Report	
OBJECTIVES	1
RESULTS	1
BACKGROUND	2
SCOPE AND METHODOLOGY	2
FOLLOW-UP PROCESS	2
Detailed Findings, Recommendations, and Management Responses	
Finding No. 1 – Untimely Review and Reconciliation of the Statement of Gross Receipts and Unauthorized Audit Report Type (Control Finding)	3
Finding No. 2 – Untimely Submission of Audited Statements of Gross Receipts (Control Finding)	4
ATTACHMENT A: Report Item Classifications	6
ATTACHMENT B: John Wayne Airport Management Responses	7



Internal Auditor's Report

Audit No. 1580

April 29, 2016

TO: Barry A. Rondinella, Airport Director
John Wayne Airport

FROM: Toni Smart, CPA, Director
Auditor-Controller Internal Audit Division

SUBJECT: Revenue Generating Lease Audit:
John Wayne Airport – Asfour Family Corporation
dba Subway, PM 1121-360-132, 132.1

OBJECTIVES

We performed an audit of certain records and documents for the period from December 1, 2014 through November 30, 2015, pertinent to the lease agreement (Agreement) between the County of Orange (County) and Asfour Family Corporation dba Subway (Subway) dated November 9, 2010. The Agreement is for five years for the operation of a Subway restaurant at John Wayne Airport (JWA).

1. The primary objective of our audit was to determine whether Subway's records adequately supported its monthly gross receipts reported to the County and rent owed was properly paid.
2. The secondary objective of our audit was to determine whether Subway complied with certain other financial provisions of the Agreement, such as monthly gross receipts statement format and annual financial statement requirements.

In addition, while performing the audit, if we identify internal control weaknesses, we will provide suggestions for improvement.

RESULTS

Objective #1: We found that Subway's records adequately supported reported gross receipts and rent was properly paid to the County.

Objective #2: We found that Subway complied with certain other financial provisions of the Agreement such as the monthly gross receipts statement format; however, we identified **two (2) Control Findings** regarding compliance with timely review and reconciliation of the annual Statement of Gross Receipts and timely submission of the annual Statement of Gross Receipts.



Detailed Findings, Recommendations, and Management Responses

BACKGROUND

The County entered into a five-year lease agreement with Asfour Family Corporation dba Subway, dated November 9, 2010, for the operation of a Subway restaurant located at John Wayne Airport. During the twelve-month audit period ended November 30, 2015, Subway reported approximately **\$1.2 million** in gross receipts and rent paid to the County was **\$194,054**.

SCOPE AND METHODOLOGY

Our audit was limited to certain records and documents that support Subway's gross receipts reported to the County for the twelve-month audit period ended November 30, 2015. Our audit included inquiry, auditor observation, and limited testing for assessing the adequacy of documentation and ensuring completeness of reported gross receipts.

FOLLOW-UP PROCESS

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). Our **First Follow-Up Audit** will begin at six months from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **Second Follow-Up Audit** will begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented. We bring to the AOC's attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. Such open issues appear on the AOC agenda at its next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendation is implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed form to facilitate our review.

The Auditor-Controller Internal Audit Division is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations.

ACKNOWLEDGEMENT

We appreciate the courtesy extended to us by the personnel at Subway and John Wayne Airport during our audit. If you have any questions regarding our revenue generating lease audit, please contact me directly at (714) 834-5442, or Nancy Ishida, Senior Audit Manager at (714) 796-8067.



Detailed Findings, Recommendations, and Management Responses

Finding No. 1 – Untimely Review and Reconciliation of the Statement of Gross Receipts and Unauthorized Audit Report Type (Control Finding)

JWA Accounting did not perform a timely review and annual reconciliation of Subway's Statement of Gross Receipts issued by the Certified Public Accountant (CPA) to the monthly Statement of Gross Receipts submitted by Subway. The reconciliation of Subway's Statement of Gross Receipts for the year ended November 30, 2013 (received May 2014) was not performed until August 2014 (three months after submission). In addition, the reconciliation incorrectly indicated that Subway had complied with the requirement to submit "audited" Statement of Gross Receipts. Subway submitted an "agreed-upon procedures" report for its Statement of Gross Receipts without obtaining prior approval as required by the lease agreement.

Lease Agreement, Section 4.06, Subsection D, Financial Statements states:

"This statement must be prepared by a Certified Public Accountant (CPA) who is a member in good standing with the American Institute of Certified Public Accountants (AICPA) or the California Society of CPAs. The audit must be performed in accordance with Generally Accepted Auditing Standards (GAAS) authorized by the AICPA....The audited statement of gross receipts shall include total gross receipts for the accounting year as classified according to the categories of business established for percentage rental and listed in Section 4.01 (RENT) and for any other business conducted on or from the Leased Premises. A reviewed statement of gross receipts may be requested by TENANT rather than an audited statement of gross receipts if there is undue hardship to obtain an audited statement. TENANT must request and obtain written approval for a reviewed statement for the Auditor-Controller prior to the start of the financial statement engagement for the year to be audited."

The reconciliation of Subway's Statement of Gross Receipts for the year ended November 30, 2014 has not been completed. JWA requested submission on November 12, 2015 and Subway submitted the audited Statement of Gross Receipts via email to JWA Business Development on November 29, 2015; however, JWA Accounting informed us that they did not receive the annual Statement of Gross Receipts from Subway.

By not performing timely reconciliations, there is a risk of not collecting amounts due for unreported gross receipts, resulting in a potential loss of revenue.

Recommendation No. 1:

We recommend JWA reconcile the annual audited Statement of Gross Receipts to the gross receipts submitted to the County in a timely manner and ensure the type of auditor's report complies with the lease agreement. We further recommend JWA monitor financial statement submission due dates to ensure the lessee complies with the terms of the lease agreement.

John Wayne Airport Management Response:

Concur. JWA Accounting will strive to reconcile the annual audited Statement of Gross Receipts to the gross receipts submitted to the County within 60 days from receipt. In addition, JWA Accounting will train staff on recognizing the appropriate report for the annual audited Statement of Gross Receipts.



Detailed Findings, Recommendations, and Management Responses

JWA Business Development will send a letter to remind applicable tenants of the requirement to submit an annual audited Statement of Gross Receipts 90 days prior to the due date. If necessary, JWA Business Development will send a reminder notice to the applicable tenants for delinquent filing on or after the due date.

Finding No. 2 – Untimely Submission of Audited Statements of Gross Receipts (Control Finding)

Subway did not submit an audited Statement of Gross Receipts for the years ended November 30, 2013 and 2014 in a timely manner. The lease agreement requires Subway to submit their Statement of Gross Receipts within 90 days after the end of each accounting year. The Statements of Gross Receipts for the years ended November 30, 2013 and 2014 were submitted in May 2014 (three months after due date) and November 2015 (nine months after due date), respectively. In addition, the statements were not audited as required by the lease agreement.

Lease Agreement, Section 4.06, Subsection D, Financial Statements states:

“Within ninety (90) days after the end of each accounting year, TENANT at its own expense shall submit to Auditor-Controller an audited statement of gross receipts for all Airport operations.”

Furthermore, Section 4.06, Subsection E. Failure to Submit Financial Statements states:

“In addition to any other remedies available to COUNTY at law or in equity or under this Lease, in the event that TENANT fails to submit any financial statements by the due date listed in this Section, Subsection “D. Financial Statements”. Airport Director may require TENANT to submit the greater of:

- 1) \$5,000 fine; or
- 2) Any and all costs incurred by COUNTY for the Certified Public Accountant hired by the COUNTY to prepare the required financial statements, including an administrative fee equal to fifteen percentage (15%) of those costs.”

Our audit found that the annual Statement of Gross Receipts were “agreed-upon procedures” reports instead of “audit” reports as required by the lease agreement (See **Finding No. 1**). We informed JWA of this issue and subsequently JWA requested that Subway submit audited Statements of Gross Receipts for the years ended November 30, 2012, 2013, and 2014 by no later than February 1, 2016. Subway submitted the audited Statement of Gross Receipts for the years ended November 30, 2012, 2013, 2014, and 2015 on January 28, 2016.

Recommendation No. 2:

We recommend that JWA require Subway to submit the audited Statement of Gross Receipts in a timely manner (within 90 days after year end). Furthermore, we recommend JWA assess whether a fine should be imposed as stipulated in the lease agreement for the failure to submit timely. JWA may take into consideration the fact that Subway later submitted audited Statement of Gross Receipts covering the last four years on January 28, 2016.



Detailed Findings, Recommendations, and Management Responses

John Wayne Airport Management Response:

Concur. JWA Business Development will send a letter to remind the Asfour Family Corporation dba Subway of the required due date to submit an annual audited Statements of Gross Receipts. JWA has evaluated the lease agreement and determined that a reminder notice will be sent to the tenant and a fine will not be imposed at this time.



Detailed Findings, Recommendations, and Management Responses

ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit findings and recommendations, we will classify audit report items into three distinct categories:

▶ **Critical Control Weaknesses:**

These are Audit Findings or a combination of Auditing Findings that represent critical exceptions to the audit objective(s) and/or business goals. Such conditions may involve either actual or potential large dollar errors or be of such a nature as to compromise the Department's or County's reputation for integrity. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

▶ **Significant Control Weaknesses:**

These are Audit Findings or a combination of Audit Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require prompt corrective actions.

▶ **Control Findings:**

These are Audit Findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.



Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: John Wayne Airport Management Responses



**JOHN WAYNE
AIRPORT**
ORANGE COUNTY

Barry A. Rondinella
A.A.E./C.A.E.
Airport Director

Memorandum

DATE: April 25, 2016

TO: Toni Smart, Director, Auditor-Controller Internal Audit Division

FROM: Barry A. Rondinella, Airport Director *BAR*

SUBJECT: Management Response to the Auditor-Controller Internal Audit Division's Report on Revenue Generating Lease Audit: John Wayne Airport – Asfour Family Corporation dba Subway

This memorandum is in response to the Auditor-Controller Internal Audit Division's Report on Revenue Generating Lease Audit: John Wayne Airport – Asfour Family Corporation dba Subway, Audit No. 1580. The Asfour Family Corporation operates a Subway restaurant at John Wayne Airport.

The audit was limited to certain records and documents that supported Subway's gross receipts reported to the County for the twelve-month period ended November 30, 2015. The audit found that an untimely review and reconciliation of the statement of gross receipts, an unauthorized audit report type, and untimely submission of the audited statements of gross receipts.

The attached management response was reviewed and approved by the County Executive Officer on April 19, 2016.

We thank the Auditor-Controller Internal Audit Division for their work and acceptance of the management response from John Wayne Airport.

Attachment

cc: Courtney Wiercioch, Assistant Airport Director, John Wayne Airport
 Ralph Sanchez, Deputy Airport Director, John Wayne Airport
 Mariane Teschner, Deputy Airport Director, John Wayne Airport
 Vivienne Thornton, Accounting Operations Manager, John Wayne Airport
 Jessie Zhu, Accounting Manager, John Wayne Airport
 Jessica Dixon, Real Property Agent, JWA Business Development
 Kenneth Wong, Manager, JWA Quality Assurance & Compliance

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Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: John Wayne Airport Management Responses (continued)

**AUDITOR-CONTROLLER
INTERNAL AUDIT DIVISION
REVENUE GENERATING LEASE AUDIT
JOHN WAYNE AIRPORT AND
ASFOUR FAMILY CORPORATION DBA SUBWAY
AUDIT NO. 1580**

Recommendation No. 1: We recommend that JWA reconcile the annual audited Statement of Gross Receipts to the gross receipts submitted to the County in a timely manner, and ensure the type of auditor's report complies with the lease agreement. We further recommend JWA monitor financial statement submission due dates to ensure the lessee complies with the terms of the lease agreement.

John Wayne Airport Management Response:

Concur. JWA Accounting will strive to reconcile the annual audited Statement of Gross Receipts to the gross receipts submitted to the County within 60 days from receipt. In addition, JWA Accounting will train staff on recognizing the appropriate report for the annual audited Statement of Gross Receipts.

JWA Business Development will send a letter to remind applicable tenants of the requirement to submit an annual audited Statement of Gross Receipts 90 days prior to the due date. If necessary, JWA Business Development will send a reminder notice to the applicable tenants for a delinquent filing on or after the due date.

Recommendation No. 2: We recommend that JWA require Subway to submit the audited Statement of Gross Receipts in a timely manner (within 90 days after year end). Furthermore, we recommend JWA assess whether a fine should be imposed as stipulated in the lease agreement for the failure to submit timely. JWA may take into consideration that fact that Subway later submitted audited Statement of Gross Receipts covering the last four years on January 28, 2016.

John Wayne Airport Management Response:

Concur. JWA Business Development will send a letter to remind the Asfour Family Corporation dba Subway of the required due date to submit an annual audited Statement of Gross Receipts. JWA has evaluated the lease agreement and determined that a reminder notice will be sent to the tenant and a fine will not be imposed at this time.