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REVENUE GENERATING LEASE AUDIT: JOHN WAYNE AIRPORT HOST INTERNATIONAL, INC.

For the Period April 1, 2008 through March 31, 2009

Host International, Inc. operates the central food and beverage concession located at John Wayne Airport. Gross receipts reported during the audit period were approximately \$16 million and rent paid to the County was approximately \$2.5 million. From the lease inception date of April 1990 through March 2009, the County has received approximately \$23 million in rent.

The Internal Audit Department found that Host International's records adequately supported gross receipts and rent owed was properly paid.

AUDIT No: 2833 REPORT DATE: AUGUST 27, 2009

County Internal Auditor: Dr. Peter Hughes, CPA
Deputy Director: Eli Littner, CPA, CIA
Senior Audit Manager: Alan Marcum, MBA, CPA
Senior Audit Manager: Autumn McKinney, CPA, CIA
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RISK BASED AUDITING

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2009 Association of Certified Fraud Examiners' Hubbard Award For the Most Outstanding Article of the Year

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GAO & IIA Peer Review Compliant - 2001, 2004, 2007

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

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OC Fraud Hotline (714) 834-3608

Letter from Dr. Peter Hughes, CPA



Transmittal Letter

Audit No. 2833 August 27, 2009

TO: Alan L. Murphy, Director John Wayne Airport

FROM: Dr. Peter Hughes, CPA

County Internal Auditor

SUBJECT: Revenue Generating Lease Audit:

John Wayne Airport, Host International, Inc.,

PM 1121-345-1, 1.1, 1.2, 1.3, 1.4, 1.5

We have completed our revenue generating lease audit of Host International, Inc. (Host) for the period April 1, 2008 through March 31, 2009. The final **County Internal Auditor's Report** is attached along with your responses to our recommendations. We performed this Revenue Generating Lease Audit in accordance with our FY 2008-09 Audit Plan approved by the Audit Oversight Committee.

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). As a matter of policy, our **first Follow-Up Audit** will now <u>begin</u> at <u>six months</u> 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 now begin at <u>six months</u> from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are 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 document to facilitate our review.

Letter from Dr. Peter Hughes, CPA

Each month I submit an **Audit Status Report** to the BOS where I detail any material 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 BOS.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendation.

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

Attachments

Other recipients of this report are listed on the **County Internal Auditor's Report** on page 3.

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County Internal Auditor's Report



Audit No. 2833

August 27, 2009

TO: Alan L. Murphy, Director

John Wayne Airport

Veter Hughes Dr. Peter Hughes, CPA FROM:

County Internal Auditor

Revenue Generating Lease Audit: SUBJECT:

> John Wayne Airport/Host International, Inc. PM 1121-345-1, 1.1, 1.2, 1.3, 1.4, 1.5

Audit Highlight

Host operates the central food and beverage concession located at John Wayne Airport.

Gross receipts generated during the audit period were approximately \$16 million and rent paid to the County was approximately **\$2.5 million**. From the lease inception date of April 1990 through March 2009, the County has received approximately \$23 million in rent.

The Internal Audit Department found that Host's records adequately supported gross receipts and rent owed was properly paid.

OBJECTIVES

We have performed an audit of certain records and documents for the period from April 1, 2008 through March 31, 2009, pertinent to the lease agreement (Agreement) between the County of Orange (County) and Host International, Inc. (Host), dated April 6, 1990, as amended. The Agreement is for the operation of the central food and beverage concession at John Wayne Airport. Our audit objectives are:

- (1) The primary purpose of our audit is to determine whether Host's records adequately support their monthly gross receipts reported to the County and rent owed is properly paid.
- (2) The secondary purpose of our audit is to determine whether Host complies with certain other financial provisions of the Agreement, such as accounting methods, monthly gross receipts statement format, and annual financial statement requirements.

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

BACKGROUND

The County of Orange entered into an Agreement with Host International, Inc. (Host), dated April 6, 1990 for the operation of the central food and beverage concession located at John Wayne Airport. Currently, Host operates 11 food locations at JWA including 1 sit-down restaurant/bar, 1 bakery/café, 2 bars/lounges, 3 Starbucks concessions, 2 snack bars, and 2 Wolfgang Puck kiosks. The Agreement expired on June 30, 2008 and currently Host is on a month-to-month tenancy. During the audit period, Host reported approximately \$16 million in gross receipts and paid the County approximately \$2.5 million in rent. From the Agreement inception date of April 1990 through March 2009, the County has received approximately \$23 million in rent.

County Internal Auditor's Report



SCOPE

Our audit was limited to certain records and documents that support Host's gross receipts reported to the County for the 12-month period of April 1, 2008 through March 31, 2009. Our audit included inquiry, auditor observation, and limited testing for assessing the adequacy of documentation and ensuring completeness of reported gross receipts.

RESULTS

Below are the results of our audit:

Objective #1 – Adequate Records: Determine whether Host's records adequately support monthly gross receipts reported to the County and rent owed is properly paid.

Results: We found that overall Host's records adequately supported the reported gross receipts and rent owed was properly paid. We noted **two (2) Control Findings** where recordkeeping should be enhanced to support the reported gross receipts. (See page 4 and 5 for details)

Objective #2 - Compliance: Determine whether Host complies with certain other financial provisions of the agreement.

Results: We found that Host complied with certain other financial provisions of the agreement such as accounting methods, annual financial statements and monthly gross receipts statement format.

We noted **one (1) Control Finding** regarding clarification of the proper rent classification for merchandise sales. (See page 6 for details)

See all **three (3) Control Findings** in the Detailed Findings, Recommendations, and Management Responses section of this report. See **Attachment A** for a description of report item classifications.

ACKNOWLEDGMENT

We appreciate the courtesy and cooperation extended to us by the personnel at Host, JWA/Business Development, JWA/Accounting Services, and JWA/Quality Assurance & Compliance. If you have any questions regarding our revenue generating lease audit, please call me directly; or Eli Littner, Deputy Director at (714) 834-5899, or Autumn McKinney, Senior Audit Manager at (714) 834-6106.

Attachment A: Report Item Classifications
Attachment B: John Wayne Airport Responses

County Internal Auditor's Report



Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Loan Leblow, Assistant Airport Director
Roy Freeman, Deputy Airport Director, JWA/Business Development
David De Leon, Administrative Manager, JWA/Business Development/Asset
Management
Steve Siemion, Deputy Airport Director, JWA/Finance & Administration
Lisa Kawashima, Accounting Manager, JWA/Accounting
Scott Suzuki, Manager, JWA/Quality Assurance & Compliance
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisor



Audit Objective #1 – Adequate Records

1. Supporting Documentation Retention (Control Finding)

Clause 15 of the Agreement states that Host's records and supporting source documents related to the Agreement shall be kept and made available for audit at one location within the limits of the County of Orange. The records must be supported by source documents such as sales slips, cash register tapes, purchase invoices, or other pertinent documents. JWA policy requires supporting documentation to be maintained for the current fiscal year and an additional five years.

Finding No. 1: Documentation supporting the daily balancing (i.e. cash count sheets, close-out tapes, voids, refunds, etc.) is maintained for 60 days and then destroyed.

Recommendation No. 1: We recommend that JWA require Host to retain the daily balancing documentation for the current fiscal year and an additional five years.

JWA Response: Concur. This recommendation has been implemented. In a letter dated August 11, 2009, we have instructed Host to retain daily sales media in accordance with the County's retention policy as stated in the recommendation.

2. Grand Total Accumulator (Control Finding)

Clause 15 of the Agreement requires that cash registers used to record sales be equipped with devices which lock in sales totals or with counters which are not resettable. The Agreement further states that the totals registered shall be read and recorded at the beginning and end of each business day. The difference in the grand total accumulator from one day to the next should agree to total sales for the day.

Host's point of sale (POS) cashiering system generates a grand total accumulator total for each location for each day. This total appears on the daily POS system report for each location.

Finding No. 2: During testing, we noted variances between the grand total accumulator and the daily sales totals that appear to be occurring almost daily. It appears that void transactions are responsible for most of the variance since voids are not deducted from the grand total accumulator total. However, Host was unable to provide an explanation for the remaining variances.

Out of three dates and four locations tested in March 2009 (for a total of 12 instances tested), we noted five small unexplained variances occurring at two locations (Oasis Bar and Grill and Starbucks Central). The variances ranged from \$0.33 to \$10, for a total of \$25.48. In all five cases the change in the grand total accumulator was less than total sales, after accounting for void transactions.



We also reviewed the accumulator totals for the month of December 2008 for one location (Oasis Bar and Grill) and found unexplained variances on 23 out of 31 days. The variances (both positive and negative) ranged from \$0.93 to \$538.56, for a net total of \$680.78 or .14% of sales. In total, the change in the grand total accumulator was less than total sales after accounting for void transactions.

Based on our testing, this appears to be a systemic problem. Although the variances noted were small and do not appear to impact reported gross receipts, an explanation should be obtained.

Recommendation No. 2: We recommend that JWA require Host to investigate the cause of the grand total accumulator variances and take the necessary steps to resolve or explain the variances.

JWA Response: Concur. This recommendation has been implemented. In a letter dated August 11, 2009, we have instructed Host to take corrective action with respect to the grand total accumulator variances noted in the audit and respond back to JWA with their findings. We will follow-up with Host on their response once received to ensure this issue has been completely resolved.

Audit Objective #2 - Compliance with Agreement

3. Merchandise Sales Rent Category Clarification (Control Finding)

Host sells a small amount of retail merchandise at their Starbucks locations. Merchandise sales are reported as gross receipts in the food and non-alcoholic beverage percentage rent category (14%).

Finding No. 3: The Agreement does not clearly specify the percentage rent category for merchandise sales. In discussions with JWA, they indicated merchandise sales are permitted at the Starbucks locations, and sales of such merchandise are charged the same rent percentage as the food and beverage category. JWA plans to address merchandise sales in the Agreement upon renewal.

Recommendation No. 3: We recommend that JWA ensure that the percentage rent category for merchandise sales are addressed in the Agreement when it is renewed.

JWA Response: Concur. This recommendation has been implemented. Internal practices for contract preparation include a step to review related Internal Audit Department reports. Accordingly, JWA will ensure any future contract for this concession will address all sales categories, including merchandise.



ATTACHMENT A: Report Item Classifications

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

Material Weaknesses:

Audit findings or a combination of Significant Issues that can result in financial liability and exposure to a department/agency and to the County as a whole. Management is expected to address "Material Weaknesses" brought to their attention immediately.

Significant Issues:

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of processes or internal controls. Significant Issues do not present a material exposure throughout the County. They generally will require prompt corrective actions.

Control Findings and/or Efficiency/Effectiveness Issues:

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



ATTACHMENT B: John Wayne Airport Responses





DATE: August 20, 2009

TO: Dr. Peter Hughes, County Internal Auditor, Internal Audit Department

FROM: Alan L. Murphy, Airport Director, John Wayne Airport

SUBJECT: Report on Revenue Generating Lease Audit of Host International, Inc., PM

1121-345-1, 1.1, 1.2, 1.3, 1.4, 1.5.

This memo is in response to the Internal Audit Department's Report on Revenue Generating Lease Audit for Host International, Inc., Audit No. 2833.

Attached is our management response which was reviewed and approved by the County Executive Office on August 20, 2009. We have implemented each of the report's recommendations and will have supporting documentation available for your subsequent follow-up audit.

Attachment

cc: Loan Leblow, Assistant Airport Director

Roy Freeman, Deputy Airport Director, Business Development Steve Siemion, Deputy Airport Director, Finance & Administration

Lisa Kawashima, Accounting Manager

Scott Suzuki, Airport Assurance & Compliance Manager

David DeLeon, Business Development Manager



ATTACHMENT B: John Wayne Airport Responses

JOHN WAYNE AIRPORT
Response to the Internal Audit Department's Report on
Revenue Generating Lease Audit of Host International, Inc.
Audit No. 2833

Recommendation No. 1: We recommend that JWA require Host to retain the daily balancing documentation for the current fiscal year and an additional five years.

JWA Management Response: Concur. This recommendation has been implemented. In a letter dated August 11, 2009, we have instructed Host to retain daily sales media in accordance with the County's retention policy as stated in the recommendation.

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JWA Management Response: Concur. This recommendation has been implemented. In a letter dated August 11, 2009, we have instructed Host to take corrective action with respect to the grand total accumulator variances noted in the audit and respond back to JWA with their findings. We will follow-up with Host on their response once received to ensure this issue has been completely resolved.

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