



INTERNAL AUDIT DEPARTMENT

ORANGE COUNTY

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Integrity ♦ Objectivity ♦ Independence

REVIEW OF LEASE REVENUE NEWPORT FBO Two, LLC DBA ATLANTIC AVIATION FBO

**For the Period
April 1, 2006 through March 31, 2007**

AUDIT NUMBER: 2644

REPORT DATE: SEPTEMBER 21, 2007

Audit Director:	Peter Hughes, Ph.D., CPA
Deputy Director:	Eli Littner, CPA, CIA
Senior Audit Managers:	Autumn McKinney, CPA, CIA
	Alan Marcum, CPA, CIA
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**REVIEW OF LEASE REVENUE
NEWPORT FBO TWO, LLC dba ATLANTIC AVIATION FBO**

**For the Period
April 1, 2006 through March 31, 2007**

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*Providing Facts and
Perspectives Countywide*

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ORANGE COUNTY
BOARD OF SUPERVISORS'
INTERNAL AUDIT DEPARTMENT

Transmittal Letter

Audit No. 2644

September 21, 2007

TO: Alan L. Murphy, Director
John Wayne Airport

FROM: Peter Hughes, Ph.D., CPA, Director
Internal Audit Department

SUBJECT: Review of Lease Revenue for Newport FBO Two, LLC dba
Atlantic Aviation, Parcel No. PM 1121-223-12.02, 12.4, 12.5
(Fixed Base Operation)

We have completed our review of lease revenue for Newport FBO Two, LLC dba Atlantic Aviation for the period April 1, 2006 through March 31, 2007. The final **Internal Auditor's Report** is attached along with your responses to our recommendations.

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 begin at six months upon 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 listing.

The AOC and BOS expect the 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 12 months from the release of the original report, by which time **all** audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we 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 public agenda at their next scheduled quarterly meeting for discussion.

We have attached a Follow-Up Audit Report Form. John Wayne Airport should complete this template as our audit recommendations are implemented. When we perform our **Follow-Up Audit** approximately six months from the date of this report, we will need to obtain the completed document from you to facilitate our review.

*Alan Murphy, Director
John Wayne Airport
September 21, 2007
Page ii*

Each month I submit an **Audit Status Report** to the Board of Supervisors (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 John Wayne Airport so you 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 recommendations.

Additionally, we will request John Wayne Airport complete a Customer Survey of Audit Services. You will receive the survey shortly after the distribution of our final report.

Attachment

Other recipients of this report:

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, Manager, JWA/Parking, Ground Transportation and Special Projects

Barbara Swift, Real Property Agent, JWA/Business Development

Scott Suzuki, Interim Deputy Airport Director, Finance & Administration

Cindy Wong, Accounting Manager, JWA/Accounting

Foreperson, Grand Jury

Darlene J. Bloom, Clerk of the Board of Supervisors

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**ORANGE COUNTY
BOARD OF SUPERVISORS'
INTERNAL AUDIT DEPARTMENT**

INTERNAL AUDITOR'S REPORT

Audit No. 2644

September 21, 2007

TO: Alan L. Murphy, Director
John Wayne Airport

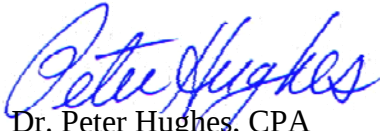
SUBJECT: Review of Lease Revenue for Newport FBO Two, LLC dba
Atlantic Aviation, Parcel No. PM 1121-223-12.02, 12.4,
12.5 (Fixed Base Operation)

We have performed a review of certain records and documents for the period from April 1, 2006 through March 31, 2007, pertinent to the lease agreement (Agreement) between the County of Orange (County) and Newport FBO Two, LLC dba Atlantic Aviation (Atlantic Aviation), original agreement dated October 24, 1994 and subsequent amendments. The Agreement is to conduct a fixed base operation at John Wayne Airport (JWA).

The primary purpose of our review is to determine whether Atlantic Aviation's records adequately supported their computation of monthly fee payments to the County. We also reviewed compliance with certain other provisions of the Agreement, such as accounting methods and payment procedures.

Based on our review, we find that Atlantic Aviation has retained sufficient documentation to adequately support monthly fees paid to the County. **No material weaknesses or significant issues were identified.** However, we did identify seven control findings which are noted in the Detailed Observations, Recommendations and Management Responses section of this report. See Attachment A for a description of report item classifications.

We appreciate the courtesy and cooperation extended to us by the personnel at Atlantic Aviation, JWA/Business Development, and JWA/Accounting Services. If you have any questions regarding our review of lease revenue, please call me, Eli Littner, Deputy Audit Director, at (714) 834-5899, or Autumn McKinney, Senior Audit Manager, at (714) 834-6106.


Dr. Peter Hughes, CPA
Director, Internal Audit

*Alan Murphy, Director
John Wayne Airport
September 21, 2007
Page 2*

Attachment A – Report Item Classifications
Attachment B – JWA Management Responses

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, Manager, JWA/Parking, Ground Transportation and Special Projects
Barbara Swift, Real Property Agent, JWA/Business Development
Scott Suzuki, Interim Deputy Airport Director, Finance & Administration
Cindy Wong, Accounting Manager, JWA/Accounting
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

EXECUTIVE SUMMARY

OBJECTIVES

The Internal Audit Department conducted a review of lease revenue for Newport FBO Two, LLC dba Atlantic Aviation (Atlantic Aviation) for the primary purpose of determining whether Atlantic Aviation's records adequately supported their monthly computation of fee payments to the County.

BACKGROUND

The County of Orange entered into a lease agreement (Agreement) with Pan Western, LTD., dated October 24, 1994, for conducting a fixed base operation to serve general aviation. In March 2001, the Agreement was assigned to Newport Beach FBO, LLC, and in December 2002, the Agreement was assigned to Newport FBO Two, LLC. In January 2005, Newport FBO Two, LLC became a subsidiary of Macquarie Infrastructure Company and began operating the fixed base operation (FBO) under the brand name of Atlantic Aviation. For the year ended March 31, 2007, Atlantic Aviation reported approximately 4.3 million gallons of delivered fuel and lubricant and \$377,183 in gross receipts from rental cars, and it paid the County approximately \$298,500 in fees.

SCOPE

Our review was to certain records and documents that support Atlantic Aviation's computation of monthly fee payments for the fuel flowage and lubricant fees and the rent-a-car fees for the 12-month period of April 1, 2006 to March 31, 2007. We also reviewed compliance with certain other provisions of the Agreement, such as accounting methods and payment procedures. Our review included inquiry, auditor observation, and testing for assessing the adequacy of documentation and ensuring completeness of reported fuel and lubricant deliveries and rental car gross receipts.

CONCLUSION

Based on our review, we find that Atlantic Aviation has retained sufficient documentation to adequately support monthly gross receipts reported to the County. **No material weaknesses or significant issues were identified.** However, we identified seven control findings which are noted in the Detailed Observations, Recommendations and Management Responses section of this report. See Attachment A for a description of report item classifications.



DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Verbal Sublease with Go Rent-A-Van

Clause 27 of the Agreement provides conditions on subletting and prior approval from JWA. A short-term sublease (five years or less) is not subject to prior approval requirement unless it covers more than twenty-five percent (25%) of the leased premise. Subleases of more than five years require prior approval from JWA.

Atlantic Aviation offers car rental services provided by a separate company Go Rent-A-Van. Go Rent-A-Van has established a service station at Atlantic Aviation's customer service counter to serve the FBO customers on site. We were informed by Go Rent-A-Van that it began operating at Atlantic Aviation in May 2003. Upon a customer's arrival, Go Rent-A-Van brings the vehicle from its separate (off-airport) location to Atlantic Aviation for customer pick-up. We were informed that Go Rent-A-Van also has its own license agreement with JWA for off-airport car rental activity at the off-site location.

Atlantic Aviation reports monthly gross receipts to the County based on the monthly revenue report and copies of rental contracts submitted by Go Rent-A-Van. Atlantic Aviation informed us that it does not receive any commission from Go Rent-A-Van. Go Rent-A-Van submits the monthly fee payment payable to the County (10% of gross receipts) to Atlantic Aviation, who in turn forwards the payment to the County.

Finding No. 1: We were informed Atlantic Aviation has no written agreement with Go Rent-A-Van and prior approval from JWA was not obtained. The prior approval may or may not have been required. The space used by Go Rent-A-Van is less than 25% of the lease premises.

JWA should evaluate this arrangement between Atlantic Aviation and Go Rent-A-Van and determine whether Clause 27 is applicable to this arrangement. For example, even if pre-approval was not required, Clause 27.C.1.b of the Agreement requires Atlantic Aviation to notify JWA of short-term subleases (less than 5 years) and provide JWA with relevant documents. In addition, Clause 27.C.1.c(2) states that should Atlantic Aviation choose not to obtain JWA's approval of short term subleases, JWA reserves the right to disallow any unapproved subleases if the sublessee has not agreed in writing to keep, perform, and be bound by all the terms, covenants, and conditions of the Agreement.

Recommendation No. 1: We recommend that JWA determine whether the arrangement between Atlantic Aviation and Go Rent-A-Van is subject to Clause 27 of the Agreement.

JWA Management Response: Concur. This recommendation has been implemented. All subleases by Atlantic Aviation are subject to Clause 27 of the Agreement; however, we determined prior approval of the Go Rent-A-Van sublease was not required. Nonetheless, the Airport reserves the right to disallow the Go Rent-A-Van sublease at any time based upon compliance with the Agreement.

Other Go Rent-A-Van Fees Not Reported to the County

Clause 8.C of the Agreement, as amended, requires Atlantic Aviation to pay ten (10) percent of the gross receipts of all rental car activities conducted on the leased premises. As noted in Finding No. 1 above, Atlantic Aviation prepares the monthly gross receipts statement to the County using Go Rent-A-Van's monthly revenue report.



Findings Nos. 2, and 3: We reviewed Go Rent-A-Van's monthly revenue report and found that Atlantic Aviation only reports time and mileage fees as gross receipts. Other fees charged by Go Rent-A-Van, such as insurance coverage, vehicle drop off, and refueling are not reported as gross receipts. Therefore, the 10% of gross receipts that Go Rent-A Van pays to the County via Atlantic Aviation is based on just on time and mileage.

For our two sample months, the underreported gross receipts were \$5,173 for August 2006 and \$3,140 for January 2007, resulting in underpayment of rent-a-car fees (10% of gross receipts) by \$517 and \$314 respectively. Both Atlantic Aviation and Go Rent-A-Van informed us that their understanding was only the time and mileage was reportable as gross receipts. However, Clause 8.C of the Agreement requires 10% on **all** rental car activities.

Recommendation No. 2: We recommend that JWA require Atlantic Aviation and Go Rent-A-Van to calculate and pay fees owed for underreported car rental gross receipts for the audit period of April 1, 2006 through March 31, 2007.

JWA Management Response: Concur. This recommendation has been implemented. In a letter dated July 16, 2007, we required Atlantic Aviation to calculate and remit fees owed from underreported gross receipts for all periods noted in this report; however, we concluded gross receipts from Go Rent-A-Van are subject to the same exclusions (e.g., CDW/collision damage waiver) granted to other Airport car rental lessees and licensees. Atlantic Aviation's regional manager acknowledged the underreporting and the Airport is in receipt of \$8,690.17 remitted from Go Rent-A-Van for all periods noted in this report. Accounting is verifying the accuracy of this amount and the Airport will resolve discrepancies with Atlantic Aviation as necessary.

Recommendation No. 3: We also recommend that JWA require Atlantic Aviation and Go Rent-A-Van to calculate and pay fees owed for the period before the audit period (May 2003 through March 2006) and after the audit period (April 2007 through the month of correction).

JWA Management Response: Concur. This recommendation has been implemented. See JWA Management Response to Recommendation No. 2.

Additionally, we will implement internal controls wherein a new form will specifically identify deductions from gross receipts. A variation of this new report was recently implemented for all on-Airport car rental lessees and allows for enhanced monitoring of reported revenues.

Discounts Reduce Go Rent-A-Van's Gross Receipts

Finding No. 4: During our testing of 20 sampled Go Rent-A-Van transactions, we found that the time and mileage fee for one transaction was reduced by \$32.33. Go Rent-A-Van informed us that the reduction was a discount given to a customer (crew member of an FBO customer). Clause 8.C does not define any items that can be excluded from gross receipts.

Recommendation No. 4: We recommend that JWA determine whether discounts are an allowable reduction to gross receipts and communicate the determination to Atlantic Aviation and Go Rent-A-Van.

JWA Management Response: Concur. This recommendation has been implemented. We determined discounts issued to FBO customer's crewmembers are not a permissible deduction from gross receipts. In a letter dated July 16, 2007, we asserted our position and required Atlantic



Aviation to calculate and remit payment on revenues foregone by these unauthorized discounts. Atlantic Aviation initially disputed our position and the Airport is discussing this matter further with them as of August 21, 2007.

Hertz Commission Payment Not Reported as Gross Receipts

In addition to using Go Rent-A-Van, Atlantic Aviation has an agreement with The Hertz Corporation (Hertz) for providing car rental services to the FBO customers. Unlike Go Rent-A-Van, Hertz does not have a workstation established on-site. Like Go Rent-A-Van, Hertz brings the vehicle from its separate (on-airport) location to Atlantic Aviation for customer pick up. Hertz informed us that it pays Atlantic Aviation 11.5% of gross receipts in commission. Hertz reports the gross receipts from Atlantic Aviation directly to the County under its own on-airport lease agreement with JWA. We were informed that Hertz began its service at Atlantic Aviation in February 2005.

Findings No. 5 and 6: We found that Atlantic Aviation did not report the commission received from Hertz as gross receipts to the County. For our two sample months, the commission received was \$428 for January 2007 and \$96 for the period January 2006 through August 2006, resulting in underpayment of rent-a-car fees (10% of gross receipts) of \$43 and \$10 respectively. Atlantic Aviation should report the Hertz commission as gross receipts and pay the fee in accordance with Clause 8.C.

Recommendation No. 5: We recommend that JWA require Atlantic Aviation to calculate and pay the rent-a-car fees owed for the audit period of April 1, 2006 through March 31, 2007.

JWA Management Response: Concur. This recommendation has been implemented. In a letter dated July 16, 2007, we required Atlantic Aviation to calculate and remit fees owed from unreported gross receipts (commissions) for all periods noted in this report. Atlantic Aviation's regional manager acknowledged the underreporting and remitted \$731.91 to the Airport for all periods noted in this report. Accounting is verifying the accuracy of this amount and the Airport will resolve discrepancies with Atlantic Aviation as necessary.

Recommendation No. 6: We also recommend that JWA require Atlantic Aviation to calculate and pay fees owed for the period before the audit period (February 2005 through March 2006) and after the audit period (April 2007 through the month of correction).

JWA Management Response: Concur. This recommendation has been implemented. See JWA Management Response to Recommendation No. 5.

Additionally, we have implemented internal controls wherein Accounting will cross-reference (1) gross receipts reported by sublessee activities at Atlantic Aviation to (2) gross receipts reported by the sublessees from their respective primary Airport locations to ensure accurate revenues are received.

Security Deposit Amount

Clause 15 of the Agreement, as amended, requires the minimum security deposit to be equal to approximately six times the monthly rents, fees and charges payable to the County. Per Clause 8 of the Agreement, as amended, the rent, fees and charges comprise of base rent, fuel flowage and lubricant fees, and rent-a-car fees.



Finding No. 7: We reviewed JWA/Business Development's calculation of the required security deposit and noted that the current security deposit amount of \$273,036 was based on the base rent only. The fuel flowage and lubricant fees and the rent-a-car fees were not included when determining the minimum security deposit amount. Based on the current monthly base rent of \$49,192 and the annual fees paid of approximately \$298,500 for our audit period, it appears that the current security deposit is about 3.7 times the monthly rent, fees and charges.

Recommendation No. 7: We recommend that JWA revise its security deposit calculation and determine if an increase to the minimum security deposit is required.

JWA Management Response: Concur. This recommendation has been implemented. Lessee security deposits are reviewed annually to ensure proper amounts are maintained and Business Development will ensure the proper components are included in future calculations. With respect to Atlantic Aviation's security deposit, the Airport has determined that an increase is warranted. In a letter dated July 16, 2007, we required Atlantic Aviation to increase their security deposit based on fees from fuel flowage, lubricant, and car rentals, in addition to base rent. Atlantic Aviation's regional manager acknowledged the shortfall by stating they have increased their letter of credit to \$427,130 (56% increase). Accounting is verifying the accuracy of this amount and the Airport will resolve discrepancies with Atlantic Aviation as necessary.



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we have classified 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 immediately address “Material Weaknesses” brought to their attention.

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:

Audit findings 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.



ATTACHMENT B: JWA Management Responses



MEMO



September 12, 2007

TO: Dr. Peter Hughes, Director
Internal Audit Department

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

(Signature)

SUBJECT: Response to the Internal Audit Department's Report on Limited Review of Lease Revenue for Newport FBO Two, LLC dba Atlantic Aviation, No. 2644

RECEIVED
INTERNAL AUDIT DEPARTMENT
2007 SEP 17 AM 10:23

I am pleased to present John Wayne Airport's management response to the Limited Review of Lease Revenue for Newport FBO Two, LLC dba Atlantic Aviation, recently completed by the Internal Audit Department. The attached management response was reviewed and approved by the County Executive Office on September 10, 2007.

While no material weaknesses or significant issues were noted in the review, we concur with each of the recommendations issued in the report and are taking the appropriate steps to resolve each issue.

On behalf of John Wayne Airport, I would like to express our appreciation for the continued professionalism and thoroughness demonstrated by the Internal Audit Department in performing this review.

Attachment

cc: Loan Leblow, Assistant Airport Director
Don Arthur, Deputy Airport Director, Finance & Administration
Roy Freeman, Deputy Airport Director, Business Development
David De Leon, Business Development Manager
Scott Suzuki, Quality Assurance & Compliance Manager
Cindy Wong, Accounting Manager
Barbara Swift, Real Property Agent



ATTACHMENT B: JWA Management Responses (continued)

JOHN WAYNE AIRPORT
Response to the Internal Audit Department's Report on
Limited Review of Lease Revenue for Newport FBO Two, LLC dba Atlantic Aviation
Audit No. 2644

Recommendation No. 1: We recommend that JWA determine whether the arrangement between Atlantic Aviation and Go Rent-A-Van is subject to Clause 27 of the Agreement.

JWA Management Response: Concur. This recommendation has been implemented. All subleases by Atlantic Aviation are subject to Clause 27 of the Agreement; however, we determined prior approval of the Go Rent-A-Van sublease was not required. Nonetheless, the Airport reserves the right to disallow the Go Rent-A-Van sublease at any time based upon compliance with the Agreement.

Recommendation No. 2: We recommend that JWA require Atlantic Aviation and Go Rent-A-Van to calculate and pay fees owed for underreported car rental gross receipts for the audit period of April 1, 2006 through March 31, 2007.

JWA Management Response: Concur. This recommendation has been implemented. In a letter dated July 16, 2007, we required Atlantic Aviation to calculate and remit fees owed from underreported gross receipts for all periods noted in this report; however, we concluded gross receipts from Go Rent-A-Van are subject to the same exclusions (e.g., CDW/collision damage waiver) granted to other Airport car rental lessees and licensees. Atlantic Aviation's regional manager acknowledged the underreporting and the Airport is in receipt of \$8,690.17 remitted from Go Rent-A-Van for all periods noted in this report. Accounting is verifying the accuracy of this amount and the Airport will resolve discrepancies with Atlantic Aviation as necessary.

Recommendation No. 3: We also recommend that JWA require Atlantic Aviation and Go Rent-A-Van to calculate and pay fees owed for the period before the audit period (May 2003 through March 2006) and after the audit period (April 2007 through the month of correction).

JWA Management Response: Concur. This recommendation has been implemented. See JWA Management Response to Recommendation No. 2.

Additionally, we will implement internal controls wherein a new form will specifically identify deductions from gross receipts. A variation of this new report was recently implemented for all on-Airport car rental lessees and allows for enhanced monitoring of reported revenues.

Recommendation No. 4: We recommend that JWA determine whether discounts are an allowable reduction to gross receipts and communicate the determination to Atlantic Aviation and Go Rent-A-Van.

JWA Management Response: Concur. This recommendation has been implemented. We determined discounts issued to FBO customer's crewmembers are not a permissible deduction



ATTACHMENT B: JWA Management Responses (continued)

from gross receipts. In a letter dated July 16, 2007, we asserted our position and required Atlantic Aviation to calculate and remit payment on revenues foregone by these unauthorized discounts. Atlantic Aviation initially disputed our position and the Airport is discussing this matter further with them as of August 21, 2007.

Recommendation No. 5: We recommend that JWA require Atlantic Aviation to calculate and pay the rent-a-car fees owed for the audit period of April 1, 2006 through March 31, 2007.

JWA Management Response: Concur. This recommendation has been implemented. In a letter dated July 16, 2007, we required Atlantic Aviation to calculate and remit fees owed from unreported gross receipts (commissions) for all periods noted in this report. Atlantic Aviation's regional manager acknowledged the underreporting and remitted \$731.91 to the Airport for all periods noted in this report. Accounting is verifying the accuracy of this amount and the Airport will resolve discrepancies with Atlantic Aviation as necessary.

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JWA Management Response: Concur. This recommendation has been implemented. Lessee security deposits are reviewed annually to ensure proper amounts are maintained and Business Development will ensure the proper components are included in future calculations. With respect to Atlantic Aviation's security deposit, the Airport has determined that an increase is warranted. In a letter dated July 16, 2007, we required Atlantic Aviation to increase their security deposit based on fees from fuel flowage, lubricant, and car rentals, in addition to base rent. Atlantic Aviation's regional manager acknowledged the shortfall by stating they have increased their letter of credit to \$427,130 (56% increase). Accounting is verifying the accuracy of this amount and the Airport will resolve discrepancies with Atlantic Aviation as necessary.

