OC Board of Supervisors'

Internal Audit Department

ORANGE COUNTY

# REVIEW OF LICENSE REVENUE FOR GAT AIRLINE GROUND SUPPORT

**For the Period**
**August 1, 2006 through July 31, 2007**


**GAT Airline Ground Support (GAT) operates commercial aviation ramp services at JWA. GAT generates annual gross receipts of approximately $1.4 million and paid fees to the County of approximately $140,000.**

**The Internal Audit Department found that GAT did not pay the correct fee percentage to the County for interior aircraft cleaning and did not pay the County fees on a 10% surcharge collected from its customer.**

**Final amounts owed are to be determined. Currently, amounts owed are calculated to be at least $73,107 and could increase by as much as another $75,000.**


AUDIT NO: 2734
REPORT DATE: JULY 24, 2008


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

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# Letter from Director Peter Hughes

## Transmittal Letter

**AUDIT NO. 2734** **July 24, 2008**

**TO:** Alan L. Murphy, Airport Director
John Wayne Airport

**FROM:** Dr. Peter Hughes, CPA, Director
Internal Audit Department

**SUBJECT:** Review of License Revenue for GAT Airline Ground Support, PM 1121-360-95

We have completed our review of license revenue for GAT Airline Ground Support for the period August 1, 2006 through July 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 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 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.

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.

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.



The Internal Audit Department is an independent audit function reporting directly to the Orange County Board of Supervisors.

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 listed on the Internal Auditor's Report on page 3.

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***Audit No. 2734***

**For the Period**
**August 1, 2006 through July 31, 2007**


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# OC Internal Audit Report

## INTERNAL AUDITOR'S REPORT

**AUDIT No. 2734** **July 24, 2008**

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

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Review of License Revenue for GAT Airline Ground Support, PM 1121-360-95

### Audit Highlight

GAT Airline Ground Support (GAT) operates commercial aviation ramp services at JWA. GAT generates gross receipts of approx. $1.4 million and paid fees to the County of approx. $140,000.

The Internal Audit Department found that GAT did not pay the correct fee percentage to the County for interior aircraft cleaning and did not pay the County fees on a 10% surcharge collected from its customer.

Final amounts owed are to be determined. Currently, amounts owed are calculated to be at least $73,107 and could increase by as much as another $75,000.

## OBJECTIVES

We have performed a review of certain records and documents for the period from August 1, 2006 through July 31, 2007, pertinent to the license agreement (Agreement) between the County of Orange (County) and GAT Airline Ground Support, Inc. (GAT), dated August 19, 2004, as amended and assigned. The Agreement is to conduct and operate commercial aviation ramp services, in-flight food catering, wash and wax operations, interior aircraft cleaning, and other contract ground services at John Wayne Airport.

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

## BACKGROUND

The County entered into an Agreement with GAT dated August 19, 2004, as amended and assigned, for the non-exclusive right to conduct and operate commercial aviation ramp services, in-flight food catering service, wash and wax operations, interior aircraft cleaning, and other contract ground services at the John Wayne Airport. During the 12-months ended July 31, 2007, GAT generated approximately $1.4 million in gross receipts and paid the County approximately $140,000 in fees.

## SCOPE

Our review was limited to certain records and documents that support GAT's gross receipts reported to the County for the 12-month period of August 1, 2006 to July 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 limited testing for assessing the adequacy of documentation and ensuring completeness of reported gross receipts.

## CONCLUSION

Based on our review, we find that GAT's records adequately supported monthly gross receipts reported to the County, except for the allocation of gross receipts for interior aircraft cleaning.

We found that GAT Airline Ground Support did not pay the correct fee percentage to the County for interior aircraft cleaning. The additional amounts owed for the interior aircraft cleaning are yet to be determined, but could be as much as $75,000.

We also found that GAT did not pay the County fees on a 10% surcharge collected from its customer. The additional amounts owed related to the 10% surcharge are $73,107, comprised of additional fees of $13,887 and $37,276 plus audit costs and late fees.

These issues are discussed further in the Detailed Observations, Recommendations and Management Responses section of the report. We consider these issues to be control findings. **No material weaknesses or significant issues were identified.** See Attachment A for a description of report item classifications.

## Acknowledgment

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

**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
Ralph Sanchez, Business Development Manager, JWA/Airlines, Concessions & Real Property Contracts
Jessica Dixon, Real Property Agent, JWA/Airlines, Concessions & Real Property Contracts
Lisa Kawashima, Accounting Manager, JWA/Accounting
Scott Suzuki, Manager, JWA/Quality Assurance and Compliance
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

## DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

### Additional Fees Owed – Interior Aircraft Cleaning

GAT provides baggage handling, aircraft towing/parking, and interior aircraft cleaning to Delta Airlines, its customer at JWA. Clause 8 of the Agreement requires GAT to pay fees to the County based on a percentage of gross receipts as follows:

- 10% for baggage handling and aircraft towing/parking
- 15% for interior aircraft cleaning

GAT charges Delta Airlines a flat amount per plane for the three services (baggage handling, aircraft towing/parking, and interior aircraft cleaning).

GAT charges four different flat amounts to Delta Airlines depending on the type of plane services as follows:

- Regular Jet - Passenger Active Flight
- Regular Jet - Remain Overnight
- Domestic Narrow Body - Passenger Active Flight
- Domestic Narrow Body - Remain Overnight

**Finding Nos. 1, 2, and 3**
GAT did not allocate a portion of the flat per plane amount to interior aircraft cleaning and pay the applicable 15% fee. Instead, GAT paid fees of 10% of the total amount. Therefore, GAT underpaid fees by 5% for the amounts allocable to interior aircraft cleaning.

We were unable to determine the fees owed to the County because GAT only records the flat amount per plane in its records and invoices and does not record details of the allocation between the three services (baggage handling, aircraft parking/towing, and interior aircraft cleaning).

As obtaining documentation to support the allocation going back in time may be difficult, JWA may want to negotiate with GAT an estimated allocation percentage. JWA should consider inquiring with some of the other fixed based operators to identify fair market rates for the services, and then determine an allocation percentage.

On a go forward basis, GAT should support the allocation with adequate documentation including detailed invoices to Delta Airlines.

For the 12-month audit period of August 1, 2006 through July 31, 2007, GAT reported $1,265,013 to the County for the flat per plane services.

**Recommendation No. 1**
We recommend that JWA require GAT to pay additional fees owed as determined by JWA for the misclassification of interior aircraft cleaning for the audit period of August 1, 2006 through July 31, 2007.

**JWA Response**
Concur. We have requested in a letter dated July 15, 2008 that GAT provide a breakdown of the flat fees noted in the audit separating charges for baggage handling and aircraft towing/parking from interior aircraft cleaning. We will review this breakdown and plan to issue a demand letter by August 29, 2008 requiring GAT to pay additional fees owed.

**Recommendation No. 2**
We also recommend that JWA determine whether GAT should pay similar fees owed for the periods of August 19, 2004 (license inception) through July 31, 2006 and August 1, 2007 through month of correction.

**JWA Response**
Concur. We will assess the fees noted in recommendation No. 1 for the periods stated in this recommendation once the breakdown is identified. We plan to have this determination by August 29, 2008.

**Recommendation No. 3**
We also recommend that for future periods depending on the outcome of recommendation No. 1. above, JWA require GAT to record sufficient details to support amounts charged for baggage handling and aircraft parking/towing vs. interior aircraft cleaning in its accounting records and its invoices to Delta Airlines.

**JWA Response**
Concur. We will require GAT to maintain documentation detailing the amounts charged for baggage handling and aircraft parking/towing vs. interior aircraft cleaning in its accounting records and related invoicing once Recommendation No. 1 is dispositioned. We plan to make this requirement effective for services provided after September 1, 2008.

## Additional Fees Owed – 10% Surcharge

Clause 9.B of the Agreement requires GAT to include as gross receipts any charges made by GAT for the sale or rendition on or from the license area of services of any nature or kind whatsoever, whether for cash or credit, whether payment is actually made or not and whether the services are actually performed or not.

GAT provides baggage handling, interior aircraft cleaning, and ramp services to Delta Airlines, its customer at JWA. GAT reports the amounts billed to Delta for these services as gross receipts to the County and pays rent of 10%.

**Finding Nos. 4 and 5**

On each monthly invoice, GAT charges Delta Airlines an additional 10% surcharge of the amount billed to recoup the monthly rent paid to the County. GAT does not report this 10% surcharge as gross receipts to the County. GAT informed us that it has never reported the surcharge as gross receipts since the license inception of August 19, 2004.

In accordance with Clause 9.B of the Agreement, this 10% surcharge should be reported as gross receipts to the County. Based on our review of GAT's invoices to Delta Airlines, we calculated additional rent owed to the County of $13,887 (10% x $138,867 in surcharges) for the audit period of August 1, 2006 through July 31, 2007.

**Recommendation No. 4**

We recommend that JWA require GAT to pay additional rent owed of $13,887 for the audit period of August 1, 2006 through July 31, 2007.

**JWA Response**

Concur. This recommendation has been implemented. JWA has demanded additional rent from GAT for the amount identified above in a letter dated June 10, 2008. Furthermore, JWA has assessed applicable late fees of $3240 in accordance with the lease provisions.

In the future, JWA will explore the possibility of explicitly identifying recovery fees charged by lessees/licensees as a component of reportable gross receipts.

**Recommendation No. 5**

We also recommend that JWA determine whether GAT should pay similar rent owed for the periods of August 19, 2004 (license inception) through July 31, 2006 and August 1, 2007 through month of correction.

**JWA Response**

Concur. This recommendation has been implemented. JWA has determined GAT should pay additional rent and late charges of $37,276 and $13,904 respectively, for the period stated in the recommendation. JWA has demanded these additional amounts from GAT in the letter noted in the response to Recommendation No. 4.

## Audit Costs

Clause 12.D of the Agreement allows the cost of the audit to be charged to GAT if the audit reveals an underpayment of more than 2% between fees owed and fees paid.

**Finding No. 6**
The additional fees owed of $13,887 as discussed above in Finding Nos. 4 and 5 exceeds 2% of the fees paid during the audit period (approximately $140,000). Therefore, audit costs of $4,800 can be assessed to GAT.

**Recommendation No. 6**
We recommend that JWA assess audit costs of $4,800 to GAT.

**JWA Response**
Concur. JWA has demanded full reimbursement from GAT for the cost of this audit in the letter noted in the response to Recommendation No. 4.

The total amount demanded from GAT as a result of Recommendation No's. 4 through 6 is $73,107.

## ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations 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: JWA Management Responses

County of Orange

**MEMO**

RECEIVED
INTERNAL AUDIT DEPARTMENT
2008 JUL 23 PM 3:43

DATE: July 21, 2008

TO: Dr. Peter Hughes, Director
Internal Audit Department

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

SUBJECT: Response to the Internal Audit Department's Report on Review of License Revenue for GAT Airline Ground Support, PM 1121-360-955

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This memo is in response to the Internal Audit Department's Review of License Revenue for GAT Airline Ground Support, a commercial aviation ramp services provider at John Wayne Airport. The review was comprised of an examination of certain records and documents for the period from August 1, 2006 through July 31, 2007.

The review found that GAT Airline Ground Support's records adequately supported monthly receipts reported to the County, except for the allocation of gross receipts for interior aircraft cleaning. No material weaknesses or significant issues were identified.

Our response was reviewed and approved by the County Executive Office on July 17, 2008.

Attachment

cc: Loan Leblow, Assistant Airport Director
Roy Freeman, Deputy Airport Director, Business Development
Lisa Kawashima, Accounting Manager
Scott Suzuki, Quality Assurance & Compliance Manager
Ralph Sanchez, Business Development Manager
Jessica Dixon, Real Property Agent

## ATTACHMENT B: JWA Management Responses Continued

JOHN WAYNE AIRPORT
Response to the Internal Audit Department's Report on
Review of Lease Revenue for GAT Airline Ground Support
Audit No. 2734

**Recommendation No. 1**
We recommend that JWA require GAT to pay additional fees owed as determined by JWA for the misclassification of interior aircraft cleaning for the audit period of August 1, 2006 through July 31, 2007.

**JWA Response**
Concur. We have requested in a letter dated July 15, 2008 that GAT provide a breakdown of the flat fees noted in the audit separating charges for baggage handling and aircraft towing/parking from interior aircraft cleaning. We will review this breakdown and plan to issue a demand letter by August 29, 2008 requiring GAT to pay additional fees owed.

**Recommendation No. 2**
We also recommend that JWA determine whether GAT should pay similar fees owed for the periods of August 19, 2004 (license inception) through July 31, 2006 and August 1, 2007 through month of correction.

**JWA Response**
Concur. We will assess the fees noted in Recommendation No. 1 for the periods stated in this recommendation once the breakdown is identified. We plan to have this determination by August 29, 2008.

**Recommendation No. 3**
We also recommend that for future periods depending on the outcome of Recommendation No. 1 above, JWA require GAT to record sufficient details to support amounts charged for baggage handling and aircraft parking/towing vs. interior aircraft cleaning in its accounting records and its invoices to Delta Airlines.

**JWA Response**
Concur. We will require GAT to maintain documentation detailing the amounts charged for baggage handling and aircraft parking/towing vs. interior aircraft cleaning in its accounting records and related invoicing once Recommendation No. 1 is dispositioned. We plan to make this requirement effective for services provided after September 1, 2008.

**Recommendation No. 4**
We recommend that JWA require GAT to pay additional rent owed of $13,887 for the audit period of August 1, 2006 through July 31, 2007.

**JWA Response**
Concur. This recommendation has been implemented. JWA has demanded additional rent from GAT for the amount identified above in a letter dated June 10, 2008. Furthermore, JWA has assessed applicable late fees of $3240 in accordance with the lease provisions.

## ATTACHMENT B: JWA Management Responses Continued

In the future, JWA will explore the possibility of explicitly identifying recovery fees charged by lessees/licensees as a component of reportable gross receipts.

**Recommendation No. 5**
We also recommend that JWA determine whether GAT should pay similar rent owed for the periods of August 19, 2004 (license inception) through July 31, 2006 and August 1, 2007 through month of correction.

**JWA Response**
Concur. This recommendation has been implemented. JWA has determined GAT should pay additional rent and late charges of $37,276 and $13,904 respectively, for the period stated in the recommendation. JWA has demanded these additional amounts from GAT in the letter noted in the response to Recommendation No. 4.

**Recommendation No. 6**
We recommend that JWA assess audit costs of $4,800 to GAT.

**JWA Response**
Concur. JWA has demanded full reimbursement from GAT for the cost of this audit in the letter noted in the response to Recommendation No. 4.

The total amount demanded from GAT as a result of Recommendation No's. 4 through 6 is $73,107.