



# Internal Audit Report

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ZRC Operations Company, Inc  
dba Qdoba

Lease and Concession Compliance Audit

January 1, 2008 through December 31, 2009

Issue Date: October 05, 2010  
Report No. 2010-11



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**Internal Audit**  
**ZRC Operations Company, Inc. dba Qdoba; Agreement No. 619**  
**Audit Period: January 1, 2008 – December 31, 2009**

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**Internal Auditor's Report**

We have completed an audit of the Lease and Concession Agreement, as amended, between the Port of Seattle and ZRC Operations Company, Inc. The purpose of the audit was to determine whether:

- 1) Reported concession was complete, properly calculated and remitted timely to the Port.
- 2) Port and the lessee complied with provisions of the Lease and Concession Agreement.
- 3) Lease and Concession Agreement, as amended, complies with applicable state and Port requirements.

We examined information related to a two-year period from January 1, 2008, through December 31, 2009.

We conducted our audit using due professional care. We planned and performed the audit to obtain reasonable assurance as to compliance with significant provisions of the agreement, including complete and timely reporting of concessionable revenues.

ZRC Operations Company, Inc. materially complied with the terms of the Lease and Concession agreement, and the agreement itself complies with applicable state and Port requirements. However, the audit disclosed instances of late payments.

We extend our appreciation to the management and staff of Aviation Business Development, and Accounting & Financial Reporting for their assistance and cooperation during the audit.

Joyce Kirangi, CPA  
Director, Internal Audit

## **Executive Summary**

**Audit Scope and Objective** The purpose of the audit was to determine the following:

1. Reported concession was complete, properly calculated and remitted timely to the Port.
2. Port and the lessee complied with provisions of the Lease and Concession Agreement.
3. Lease and Concession Agreement, as amended, complies with applicable state and Port requirements.

We examined the books and records of ZRC Operations Company, Inc. for a two-year period from January 1, 2008 through December 31, 2009. Aviation Business Development has the primary responsibility for administering and monitoring the agreement to ensure compliance with agreed-upon terms.

**Agreement Terms** Jack in the Box Inc. of San Diego acquired ZRC Operations Company Inc. in 2003.

The terms of the agreement provide for a Minimum Annual Guarantee (MAG) of 85% of the total amount paid to the Port in the previous agreement year. Additionally, the agreement requires a Percentage fee to be paid to the extent the Percentage Fee exceeds the MAG in accordance with the following structure:

- 10% - for receipts less than \$1,000,000
- 12% - for receipts greater than \$1,000,000 but less than \$1,500,000
- 15% - for receipts greater than \$1,500,000

The MAG is payable in advance, on or before the first day of each month, without notice from the Port, and without setoff or deduction. The percentage fee, if applicable, is due on or before the 15<sup>th</sup> of the following month.

For untimely payments, the agreement provides a one-time late fee of 5% of the overdue amount and interest to be accrued at the rate of 18% per annum from the due date until paid.

## **Audit Result Summary**

ZRC Operations Company, Inc. materially complied with the terms of the Lease and Concession agreement, and the agreement itself complies with applicable state and Port requirements. However, the audit disclosed instances of late payments, ranging from 3 to 16 days. The auditor's calculation of financial charges amounted to approximately \$2,204.



**Internal Audit**  
**ZRC Operations Company, Inc. dba Qdoba; Agreement No. 619**  
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## Background

The first Qdoba Mexican Grill opened in Denver in 1995. As of December 2009, there are 480 Qdoba Mexican Grill restaurants in the United States. The company considers itself the largest franchised fast-casual Mexican restaurant company.

In 2003, Qdoba was acquired by Jack in the Box Inc., a restaurant company headquartered in San Diego.

The terms of the agreement provide for a Minimum Annual Guarantee (MAG) of 85% of the total amount paid to the Port in the previous agreement year. Additionally, the agreement requires a percentage fee to be paid to the extent the Percentage Fee exceeds the MAG in accordance with the following structure:

- 10% - for receipts less than \$1,000,000
- 12% - for receipts greater than \$1,000,000 but less than \$1,500,000
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The MAG is payable in advance, on or before the first day of each month, without notice from the Port, and without setoff or deduction. The Percentage Fee, if applicable, is due on or before the 15<sup>th</sup> of the following month.

For untimely payments, the agreement provides a one-time late fee of 5% of the overdue amount and interest to be accrued at the rate of 18% per annum from the due date until paid.

## Financial Highlights

Year	Concessionable Gross	Concession
2006	2,547,978	\$344,683
2007	3,057,904	367,474
2008	3,514,557	467,513
2009	3,218,543	429,821
<b>Total</b>	<b>\$ 12,338,982</b>	<b>\$1,609,491</b>

Source: PROPworks and PeopleSoft

## Audit Objectives

The objective of our audit was to determine the following:

- 1) Reported concession was complete, properly calculated and remitted timely to the Port.
- 2) Port and the lessee complied with provisions of the Lease and Concession Agreement.
- 3) Lease and Concession Agreement, as amended, complies with applicable state and Port requirements.

## **Audit Scope**

The scope of the audit covered the period of January 1, 2008 through December 31, 2009.

## **Audit Approach**

To achieve our audit objective, we performed the following procedures:

- Read and analyzed the lease agreement, as amended.
- Reviewed applicable state and local rules and regulations.
- Identified significant provisions in the agreement.
- Obtained necessary financial and non-financial data from the lessee.
- Assessed relevant risks associate with the agreement.
- Designed and executed audit procedures based on risk.
- Analyzed data (internal & external) to determine completeness & compliance. This included performing the following additional procedures:
  - Reconciliation of the reported gross receipts to the lessee's accounting records to ensure completeness and consistency.
  - Reconciliation of the certified Audited Schedule of Gross Receipts to lessee's accounting records to ensure completeness.
  - Verified that concession fees were paid timely and intact.
  - Recalculated concession revenue and related fees to ensure accuracy.

## **Conclusion**

ZRC Operations Company, Inc. materially complied with the terms of the Lease and Concession agreement, and the agreement itself complies with applicable state and Port requirements. However, the audit disclosed instances of late payments, ranging from 3 to 16 days. The auditor's calculation of financial charges amounted to approximately \$2,204.

**Schedule of Findings and Recommendations**

**1. Untimely Payments**

The agreement, as amended under Section 4, stipulates specific payment terms for MAG and percentage fee payments as follows:

- MAG is payable in advance on or before the first day of each month.
- Percentage fee, if applicable, is due within 15 days following the end of each month.

Late payments, as stipulated under Section 8 of the agreement, are to be assessed a one-time late fee of 5% on the overdue amount, and interest of 18% per annum or the maximum allowed by the law, whichever is less.

We reviewed Qdoba payment history and noted 11 instances of late payments in 2008, and 12 instances of late payments in 2009. The summary below shows the number of days that payments were late. This summary also takes into account a ten-day grace period, which is granted in the agreement.

**Summary of Late Payments**

Year	Type of Payment	Range of Days Late	# of Instances of Late Payments	Interest Charge (18%/yr)
2008	Concession Fees	5 to 11	11	\$1,478
2009	Concession Fees	3 to 16	12	726
				\$2,204

**Recommendation**

We recommend that management collect approximately \$2,204 in finance charges and/or work with the lessee to ensure timely payments.

**Management Response**

*The late payment issues with ZRC Operations Inc. (Qdoba Mexican Grill) are related to the company's payments of percentage rent. While the company paid its Minimum Annual Guarantee at the beginning of every month, it failed to pay percentage rent concurrently with its sales reporting as required. Instead, the company reported gross sales, and then awaited receipt of the Port's invoice to confirm its percentage rent before payment was made. This practice was non-compliant with the terms of the lease agreement since the agreement requires the tenant to report gross sales and calculate/pay percentage rent at the same time. Qdoba's overall payment practices were consistent throughout the audit period. Since March 2010, when it became clear to the company that their payment practices were out of compliance with their lease terms, Qdoba immediately changed their payment practices and has been consistently paying their rent in a timely fashion. Treatment of the retroactive late fees identified in the audit will be consistent with Port policy decisions surrounding these particular fees.*