



# INTERNAL AUDIT REPORT

Limited Contract Compliance Audit  
McDonald's USA, LLC

July 2016 – June 2019

Issue Date: March 23, 2020  
Report No. 2020-02

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## Executive Summary

Internal Audit (IA) completed an audit of the Seattle-Tacoma International Airport Lease and Concession Agreement (Agreement) between McDonald's USA, LLC (McDonald's) and the Port of Seattle (Port). McDonald's pays the Port approximately one million dollars in annual concession fees.

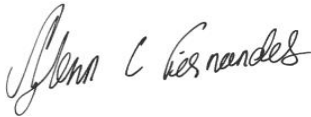
The period audited was July 2016 through June 2019. The audit was performed to determine whether McDonald's complied with significant provisions in the Agreement including whether reported gross revenues and percentage fees were complete and accurate.

Our audit identified the following issues:

**(Medium)** – McDonald's paid the July 2016 percentage fee late and was not assessed a late fee of \$1,574. McDonald's underreported gross revenue in June 2017, resulting in an underpayment of \$890. Additionally, non-product sales were not billed by the Port, resulting in \$7,801 of percentage fees underbilled by the Port.

This issue is discussed in more detail beginning on page six.

We extend our appreciation to management and staff of the Aviation Commercial Management Department and the Accounting and Financial Reporting Department for their assistance and cooperation during the audit.



Glenn Fernandes, CPA  
Director, Internal Audit

## Responsible Management Team

Rudy Caluza, Director, Accounting and Financial Reporting  
Dawn Hunter, Senior Manager, Airport Dining & Retail  
Linda Nelson, Assistant Director, Financial Reporting Revenue Services  
Jim Schone, Director, Aviation Business Development

## Background

In September of 2012, the Port entered into an Agreement with McDonald's. The terms of the Agreement provide for a Minimum Annual Guarantee (MAG) equal to 85% of the total amount paid to the Port for the previous agreement year. The MAG is payable, in advance, on or before the first day of each month. Additionally, the Agreement requires payment of a Percentage Fee equal to a percentage of gross revenue, provided the fee is higher than the MAG. The Percentage Fee is due on or before the fifteenth day of each succeeding month, according to the following schedule:

Annual Gross Revenue	Percentage (%) of Gross Sales
\$1 to \$2,780,000	9%
\$2,780,001 to \$3,630,000	11%
Over \$3,630,000	13%

Within 60 days after the close of each Agreement Year, McDonald's is required to provide the Port an annual report reflecting the amount of Gross Sales for the preceding Agreement Year. The annual report shall be accompanied by a signed certificate of an independent Certified Public Accountant or a Director of McDonald's that specifically states a) he/she examined the annual report, b) the examination included such tests that were considered necessary or appropriate under the circumstances, c) the information was presented fairly, and d) conforms with and was computed in compliance with the definitions set forth in the Agreement.

The table below reflects the total concession revenue and percentage fees billed:

Agreement Year	Gross Revenue*	Concession Fees
July 2016 - June 2017	\$5,785,728	\$699,947
July 2017 - June 2018	7,373,808	920,671
July 2018 - June 2019	8,854,096	1,126,413
Total	\$22,013,632	\$2,747,031

Data Source: PeopleSoft Financials, AFR YE documents

\*Non-product sales deducted

## **Audit Scope and Methodology**

We conducted the engagement in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and conduct an engagement to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our engagement objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our engagement objectives.

The period audited was July 2016 through June 2019 and included the following procedures:

### Revenue Completeness, Accuracy, Timeliness

- Agreed monthly revenue reports provided to the Port, to McDonald's general ledger.
- Validated that the annual report was submitted and signed by an independent CPA or a director from McDonald's.
- Reviewed the Agreement definition of Gross Sales, including exclusions, and reviewed McDonald's records such as the chart of accounts, revenue reports, and general ledger, to determine the completeness of prior years' reporting.
- Recalculated the MAG and Percentage Fees to verify accuracy.
- Verified timeliness of payments for all months in the audit period.

## Schedule of Findings and Recommendations

### 1) Rating: Medium

**McDonald's paid the July 2016 percentage fee late and was not assessed a late fee of \$1,574. McDonald's underreported gross revenue in June 2017, resulting in an underpayment of \$890. Additionally, non-product sales were not billed by the Port, resulting in \$7,801 of percentage fees underbilled by the Port.**

#### Late Payment

Internal Audit reviewed timeliness of payments and found the July 2016 concession fees payment was paid six days late. Section 8 of the lease agreement states, in part: "...if any installment of Rent or any other sum due from Lessee shall not be received by the Port within ten (10) days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall pay the Port a late charge equal to five percent (5%) of such overdue amount." The payment amount was \$31,489; therefore, the late fee is \$1,574.

#### Revenue Understatement

Profit and Loss statements were obtained from McDonald's for the audit scope period. Upon review, Internal Audit found June 2017 gross revenue was understated by \$6,410. Percentage fees totaling \$890 has not been paid to the Port.

#### Non-Product Sales

At the end of each agreement year, "non-product" sales were removed from gross revenue. This reduced the percentage fee amount billed. Internal Audit determined that "non-product" sales were not allowable deductions per the Agreement. Although AFR did not bill percentage fees on the "non-product" sales, McDonald's paid percentage fees on these sales and has a credit balance on their account.

Agreement Year	Deductions	Percentage Fee
July 2016 - June 2017	\$16,954	\$2,356
July 2017 - June 2018	24,809	3,448
July 2018 - June 2019	14,369	1,997
Total	\$56,132	\$7,801

#### **Recommendations:**

1. AFR should collect \$1,574 in unpaid late fees.
2. AFR should seek and recover \$890 in unpaid percentage fees. Assess the applicability of a one-time late charge and any accrued interest.
3. AFR should bill \$7,801 in percentage fees resulting from the deduction of non-product sales at year-end, reducing the credit balance on McDonald's account.

#### **Management Response/Action Plan:**

Aviation Commercial Management will seek to recover the late fee for July 2016 concession fees, which Internal Audit calculated as \$1,574. Aviation Commercial Management will also reach out to the tenant to ensure awareness that payments should be received by the due date stated in the agreement or outstanding amounts will be subject to late fees. Currently, Port contracts have varying terms regarding due dates and grace periods, among others, which complicates the potential for

automating the calculation of late fees. These complications contribute to the current manual process which occurs three times a month and which calculates fees on prescribed dates. Thus, there is a risk of missed late fees, such as the one identified in this audit report, due to the varying terms in the Port's agreements. Aviation Commercial Management will work with the Port's Accounting and Financial Reporting department, which runs the late fee process, to find opportunities to standardize agreement terms when contracts are executed or renewed.

Aviation Commercial Management will seek to recover the revenue understatement for June 2017, which Internal Audit calculated as \$890.

Accounting and Financial Reporting (AFR) will recover 2016-2018 unbilled revenue, which Internal Audit calculated as \$7,801. The customer's certified annual report excluded items from gross sales that were product sales resulting in unbilled amounts. AFR will work with customer to match existing credits on account to clear these items. Aviation Commercial Management will work with the Port's Accounting and Financial Reporting department, which trues up annual reporting, to find opportunities to standardize reporting when contracts are executed or renewed.

**DUE DATE: 6/30/2020**

## Appendix A: Risk Ratings

Findings identified during the audit are assigned a risk rating, as outlined in the table below. Only one of the criteria needs to be met for a finding to be rated High, Medium, or Low. Findings rated Low will be evaluated and may or may not be reflected in the final report.

Rating	Financial Stewardship	Internal Controls	Compliance	Public	Commission/ Management
<b>High</b>	Significant	Missing or not followed	Non-compliance with Laws, Port Policies, Contracts	High probability for external audit issues and / or negative public perception	Requires immediate attention
<b>Medium</b>	Moderate	Partial controls Not functioning effectively	Partial compliance with Laws, Port Policies Contracts	Potential for external audit issues and / or negative public perception	Requires attention
<b>Low</b>	Minimal	Functioning as intended but could be enhanced to improve efficiency	Mostly complies with Laws, Port Policies, Contracts	Low probability for external audit issues and/or negative public perception	Does not require immediate attention