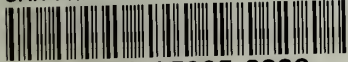


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City and County of San Francisco

Office of the Auditor

## AIRPORT COMMISSION:

### Concession Audit of SFO Equities, LLC, dba Burger King

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# City and County of San Francisco

Office of the Controller – City Services Auditor

## **AIRPORT COMMISSION:**

### **Concession Audit of SFO Equities, LLC, dba Burger King**

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*January 31, 2008*

**CONTROLLER'S OFFICE  
CITY SERVICES AUDITOR**

The City Services Auditor was created within the Controller's Office through an amendment to the City Charter that was approved by voters in November 2003. Under Appendix F to the City Charter, the City Services Auditor has broad authority for:

- Reporting on the level and effectiveness of San Francisco's public services and benchmarking the city to other public agencies and jurisdictions.
- Conducting financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operating a whistleblower hotline and website and investigating reports of waste, fraud, and abuse of city resources.
- Ensuring the financial integrity and improving the overall performance and efficiency of city government.

The audits unit conducts financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

We conduct our audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Cynthia Fong, Audit Manager  
Edvida Moore, Associate Auditor





**CITY AND COUNTY OF SAN FRANCISCO**  
**OFFICE OF THE CONTROLLER**

**Ed Harrington**  
**Controller**

**Monique Zmuda**  
**Deputy Controller**

January 31, 2008

San Francisco Airport Commission  
P.O. Box 8097  
San Francisco International Airport  
San Francisco, CA 94128-8097

President and Members:

The Controller's Office, City Services Auditor presents its report concerning the audit of SFO Equities, LLC, dba Burger King. Effective September 2004, SFO Equities began operating two Burger King fast food facilities at the San Francisco International Airport under a 10-year lease with the Airport Commission. The first Burger King, located in the food court on the mezzanine of Domestic Terminal 3, began operations on September 1, 2004; the other, located at Gate 74 of Terminal 3, Boarding Area F, began operations on September 18, 2004. Although the lease as originally signed was intended to expire in 2016, SFO Equities' lease with the Airport Commission for the Burger King facilities was terminated and assigned to Burger King Corporation effective July 12, 2007.

**Reporting Period:** September 1, 2004, through July 31, 2007

**Rent Paid:** \$495,482

**Results:**

SFO Equities correctly reported gross revenues of \$5,664,725 to the Airport Department (Airport); however, SFO Equities underpaid its concession rent by \$43,416. The major factor contributing to this was SFO Equities' use of a September 1 to August 31 lease year in its calculations of percentage rent rather than the January 1 to December 31 lease year stated in its lease with the Airport.

The responses from the Airport and SFO Equities are attached to this report.

Respectfully submitted,

Harriet Richardson  
Director of Audits

cc: Mayor  
Board of Supervisors  
Civil Grand Jury  
Budget Analyst  
Public Library  
SFO Equities, LLC  
Burger King Corporation  
John R. Martin, Director, San Francisco International Airport

# INTRODUCTION

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## Background

SFO Equities, LLC,<sup>1</sup> operated two Burger King fast food facilities at the San Francisco International Airport (SFO) under Lease 03-0189 with the Airport Commission (Commission). SFO Equities opened the Burger King facility located in the food court on the mezzanine of Domestic Terminal 3 for operations on September 1, 2004. The second Burger King facility, located at Gate 74 of Terminal 3, Boarding Area F, began operations on September 18, 2004. The lease requires SFO Equities to pay the Airport the greater of a minimum annual guarantee or a tiered percentage rent of 8 to 12 percent of annual total gross revenues.

## Objectives

The objectives of this audit were to determine whether:

- The monthly statements of gross revenues that Burger King submitted to the Airport accurately reflect its gross revenues based on monthly and daily records.
- Burger King paid the proper amount of rent, according to the terms of its lease agreement.
- Burger King currently has no overdue amounts payable to the Airport for the audit period.

## Scope and Methodology

Our audit covered the period from September 1, 2004, through July 31, 2007. To conduct the audit, we examined the applicable terms of the permits and lease and the adequacy of SFO Equities' procedures for collecting, recording, summarizing, and reporting its gross revenues to the Airport. To determine whether SFO Equities accurately reported its gross revenues to the Airport, we compared its reported gross revenues to those recorded in its internal monthly summary records for all months of the audit period. We tested, on a sample basis, SFO Equities' monthly sales records, 18 days' worth of daily sales reports, and bank statements. We also determined whether SFO Equities had any outstanding payments due to the Airport for the audit period.

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<sup>1</sup> SFO Equities is a subsidiary of WSE Group, which holds other lease agreements with the Airport.

**Auditor's Comments  
on Airport's and SFO  
Equities' Responses**

The Airport agrees with our audit findings (see Appendix A). However, in its response to the audit (see Appendix B), SFO Equities states that it paid rent to the Airport correctly, based not upon the calendar year, but rather, upon the September 2004 opening of its Burger King facilities. However, the lease specifically defines the term "lease year" as "the period commencing on January 1 and ending on December 31 of each year." While SFO Equities' contention is true that restaurants may open for business on dates other than January 1, Section 4.3(e) of the rent states "the minimum annual guarantee [rent] with respect to the first lease year shall be prorated, based on a 365-day year, to reflect the fact that the first lease year shall be less than a full 12-month period" (thus allowing for an opening that falls on a date other than January 1). The other issues that SFO Equities addresses in its response to the audit report emphasize the fact that the Airport and SFO Equities need to discuss, and reach a common understanding about, the terms of their lease agreement.

Section 20.4 of the lease requires a written instrument for terms or provisions of the lease to be changed, waived, discharged or terminated. No such written instrument that would have permitted SFO Equities to deviate from the terms of its lease with the Airport was executed during the audit period. As such, we stand by our audit findings.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



## RESULTS

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### **SFO Equities Underpaid its Rent to the Airport**

*SFO Equities made errors in calculating percentage rent*

SFO Equities accurately reported \$5,664,725 in gross revenues to the Airport. It paid the Airport \$495,482 in percentage rent, an underpayment of \$43,416.

The lease requires SFO Equities to pay the Airport a base rent per lease year. The lease specifically defines the term "lease year" as "the period commencing on January 1 and ending on December 31 of each year." Base rent is the greater of the minimum annual guarantee (MAG) or the percentage rent. The lease defines percentage rent as the sum of:

- a) 8 percent of gross revenues achieved up to and including \$750,000, plus,
- b) 10 percent of gross revenues achieved from \$750,000.01 up to and including \$1,200,000, plus,
- c) 12 percent of gross revenues achieved over \$1,200,000.

SFO Equities underpaid its rent by \$43,416 because:

- It did not use the prescribed lease year of January 1 through December 31 to calculate percentage rent due to the Airport. Instead, SFO Equities used a lease year of September 1 through August 31. This caused SFO Equities to apply the tiered percentage rent rates to gross revenues at incorrect intervals, resulting in a calculation of \$504,289 as the amount of rent due for the audit period. Using the correct lease year, we determined that total percentage rent due for the audit period should have been \$538,898 (\$34,609 greater than the amount that SFO Equities had calculated).
- Although SFO Equities calculated rent due at \$504,289, it paid the Airport only \$495,462 in percentage rent, which was \$8,807 less than it determined was due to the Airport.
- These errors resulted in an underpayment to the Airport for percentage rent of \$43,416 (\$34,609 plus \$8,807).

Exhibit 1 shows the effect of these errors on percentage rent due to the Airport for each lease year (or portion thereof) included in the audit period.

*Airport accounting reinforced  
SFO Equities' error in  
calculating percentage rent*

SFO Equities' controller requested help from her contact in the Airport Accounting Division on the proper method for calculating percentage rent. SFO Equities had been using September 1 as the beginning of its lease year, and the Accounting Division did not inform SFO Equities that the lease requires a lease year beginning January 1. Instead, the Accounting Division prepared a schedule for SFO Equities demonstrating the mechanics of percentage rent calculation, but using the incorrect lease year.

**Contract language  
should be more specific  
to avoid ambiguity**

There were several instances in which SFO Equities did not comply with the terms of its lease agreement with the Airport. However, the Airport Revenue Development and Management Office (property management office) did not apply any of the requisite penalties stated in the lease.

- Although scheduled to open for business on the rent commencement date (RCD), September 1, 2004, the Burger King franchise located at Gate 74 did not open for business until September 18, 2004. The delay occurred because SFO Equities had installed a ventilator at the Gate 74 location that the Airport considered inadequate for effectively removing food odors; therefore, the Airport asked SFO Equities to install a better ventilator.

Section 2.3 of the lease imposes a late opening charge of \$500 for each day after the RCD until the day on which the tenant opens the facility for business. Not only did the Airport not apply this \$8,500 penalty (\$500 x 17 days), it also prorated SFO Equities' MAG (from \$6,060 to \$4,167) for September 2004. If it were determined that SFO Equities were responsible for the delay, then an additional \$1,893 would be due to the Airport.

More specific contract language would have helped determine if the delay resulted from the inadequacy of the ventilator that SFO Equities initially installed, or from the Airport's request that the ventilator be upgraded. Clarifying the language would also preclude the Airport from choosing whether or not to apply a penalty.

| <b>EXHIBIT 1</b> <b>Comparative Analysis of Percentage Rent Due –Lease Year Beginning January 1<sup>st</sup> vs. September 1<sup>st</sup></b> |                                |  |  |                                |                         |   |                                   |
|---|--------------------------------|--|--|--------------------------------|-------------------------|---|-----------------------------------|
| <b>A</b>  | <b>B</b>                       | <b>C</b>                                   | <b>D</b>                                       | <b>E</b>                       | <b>F</b>                | <b>G</b>  | <b>H</b>                          |
| <b>Lease Year</b>   | <b>Gross Revenues Reported</b> | <b>Auditors' Calculation of % Rent Due</b> | <b>SFO Equities' Calculation of % Rent Due</b> | <b>Over/(Under) Calculated</b> | <b>Actual Rent Paid</b> | <b>Over/(Under) Paid Using SFO Equities Calculation</b> | <b>Total Over/(Under) Payment</b> |
| 9/2004 – 12/2004  | \$ 792,148                     | \$ 64,215                                  | \$ 63,372                                      | (= D – C)<br>(\$ 843)          | \$ 59,205               | (= F – D)<br>(\$ 4,167)                                 | (= C – F)<br>(\$ 5,010)           |
| 1/2005 – 12/2005  | 2,083,644                      | 211,037                                    | 166,692  | (44,345)                       | 170,859                 | 4,167   | (40,178)                          |
| 1/2006 – 12/2006  | 1,937,638                      | 193,517                                    | 190,966  | (2,551)                        | 193,175                 | 2,209   | (342)                             |
| 1/2007 – 7/2007   | 851,295                        | 70,129                                     | 83,259   | 13,130                         | 72,243                  | (11,016)  | 2,114                             |
| <b>TOTAL</b>  | <b>\$5,664,725</b>             | <b>\$ 538,898</b>                          | <b>\$ 504,289</b>                              | <b>(\$ 34,609)</b>             | <b>\$ 495,482</b>       | <b>(\$ 8,807)</b>                                       | <b>(\$ 43,416)</b>                |

Sources: Airport accounting monthly sales reports and FAMIS cash receipts report (obtained via EIS), as generated by the Office of the Controller, Accounting Operations and Systems Division.



- SFO Equities was often late in submitting its percentage rent payments to the Accounting Division. This was evidenced by the numerous delinquent and/or three-day demand notices that the property management office had to issue to SFO Equities for payment.

The lease imposes a service charge equal to the lesser of 1.5 percent per month or the maximum rate permitted by law. However, the property management office entered into several installment payment plans with SFO Equities' president and waived the late payment service charges.

- Section 4.5 of the lease, Annual Report and Adjustment, states:

Within ninety (90) days after the end of each lease year, Tenant shall submit to director an unqualified year-end financial report certified by a certified public accountant (CPA) or a year-end financial report certified by Tenant's chief financial officer, **if such officer is approved by the director** [emphasis added], showing gross revenues achieved with respect to the prior Lease Year.

While SFO Equities did submit an Annual Report of Gross Revenue to the Airport Director for each lease year, the report was not certified by SFO Equities' CPA or its chief financial officer. Instead, the report was signed by the SFO Equities' controller. Even if it could be said that the controller was, in fact, the chief financial officer, there was no record that the controller had been approved by the Airport Director for the purpose of certifying the year-end financial report. Despite this, the Airport accepted the report as submitted by SFO Equities. Note that in the annual report of gross revenue, SFO Equities correctly identifies the lease year as beginning with January and ending in December. Despite SFO Equities' apparent awareness of what constitutes a lease year, it computed percentage rent due to the Airport using an incorrect lease year.

#### **Transfer of lease to Burger King Corporation**

Effective July 12, 2007, under Airport Commission Resolution No. 07-0103, the City approved a consent to transfer the lease from SFO Equities (Assignor) to Burger King Corporation (Assignee). The terms and conditions of

the resolution state, in part:

3. Following the transfer, Assignor and Assignee shall be responsible for the Tenant's entire obligation under the Lease, **including but not limited to any obligations that accrued before the date of the transfer** [emphasis added].
4. Upon the occurrence and during the continuance of a default under the lease, City shall have the right to collect the rent attributable to the Premises directly from Assignee, without waiving any of City's rights or remedies against Assignor with respect to such default. City shall have no obligation to seek Assignor's consent. ...

## Recommendations

Based on the terms and conditions of the resolution approving assignment of the lease from SFO Equities, LLC, to Burger King Corporation, the following recommendations are equally applicable to both entities. The Airport should:

1. Bill and collect \$43,416 from Burger King Corporation for SFO Equities' underpaid percentage rent.
2. Review all lease agreements with SFO Equities' parent company, WSE Group, Inc., to ensure that all of its subsidiaries use the correct lease year to calculate percentage rent due to the Airport. In any instances where the percentage rent due has been incorrectly calculated, bill WSE Group, Inc., for the balance due.
3. Ensure that Burger King Corporation uses the correct lease year to calculate percentage rent due to the Airport.
4. Work with the appropriate City personnel to draft more specific contract language for this and similar leases.



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# APPENDIX A: DEPARTMENT RESPONSE

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San Francisco International Airport

January 7, 2008

Ms. Harriett Richardson  
Director of Audits  
City Hall  
1 Dr. Carlton B. Goodlett Place, Room 316  
San Francisco, CA 94102-4694

Subject: Audit of SFO Equities, LLC, dba Burger King

Dear Ms. Richardson:

We have reviewed the subject audit and offer the following response to your recommendations:

1. The Airport will invoice SFO Equities, LLC or Burger King Corporation \$43,416 in reflection of the audit findings.
2. The Airport will review and ensure that rent was calculated and paid correctly for the other WSE Group, Inc. lease (Boarding Area B Casual Bar and Dining dba San Francisco Legends).
3. The Airport will remind Burger King Corporation of the lease year and that the minimum annual guarantee and percentage rent structure is applied to lease years.
4. The Airport is in the process of updating lease agreement language and will be more explicit about percentage rent structures during lease years which are less than twelve months.

Thank you for your work on this audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Cheryl Nashir".

Cheryl Nashir  
Associate Deputy Airport Director  
Revenue Development and Management

A handwritten signature in black ink, appearing to read "Caesar Sanchez".

Caesar Sanchez  
Chief Fiscal Officer

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# APPENDIX B: AUDITEE RESPONSE

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## SFO EQUITIES, LLC

January 7, 2008

Harriet Richardson, Director of Audits  
Controller's City Services Auditor  
City Hall, Room 476  
#1 Dr. Carlton B. Goodlett Place  
San Francisco, CA 94102-4694

Dear Ms. Richardson:

We are in receipt of your audit review of SFO Equities, LLC's operations of two Burger King Restaurants located at San Francisco Airport. This review began May 24, 2007 and concluded with your results being received in writing on December 20, 2007.

We have reviewed your audit report and we do not agree with your findings on the underpayment of rents. SFO Equities, LLC paid rent on the "lease year" which commenced on the date of the restaurants opening September 2004 and not on a calendar year as you state in your findings. We correctly paid all rents due Airport Properties. There is no way to pay rents based on a calendar year as restaurant openings happen at all different times of the year - not just on January 1 of any calendar year.

I have enclosed as a sample the method used to report rents to the airport each month since September 2004. This spreadsheet was forwarded to me by Ivo Castellanos, SF Airport Acctg Division and we would update and submit this report monthly. At no time was I ever contacted by anyone at SF Airport Acctg Division that I was completing a form incorrectly or reporting any revenues incorrectly.

You also noted that in the annual report of gross revenue, SFO Equities identifies the lease year as beginning with January. The annual report of gross revenue is a blank form provided by the airport each year with instructions stating that you are to fill in with the beginning month that fits with your restaurant opening and continue on the form for a 12 month period. As our copy showed, our first completed revenue line was September 2004 and continued on from there.

In regards to the delay in opening Gate 74 Burger King, the delay was not a result of SFO Equities' faulty "ventilator" as you state in your audit report. The airport installed the Smoke Hog (ventilator, as you stated) and there were problems associated with its operation which caused the delay. Again, it was not our Burger King approved equipment that caused the delay. Therefore, we disagree with your findings that we violated our lease thus making us subject to the \$500 per day fine.

I hope that this clarifies points that we disagree with in your audit report. As always, please feel free to contact me at (650) 348-0556 with any questions you might have.

Regards,



Robbi Hollon  
Controller

RH:lom

Enclosures

533 AIRPORT BLVD. SUITE 523 • BURLINGAME, CA • 94010  
PHONE: 650,348-0556 • FAX: 650,348-0557

SFO Equities, LLC

This spread sheet was created by Ivo Castellanos @ SFO

**Burger King**

Statement of Sales and Rent Due - September 2005 to August 2006

|               | T1<br>Gate 74<br>Sales | T3<br>Mezzanine<br>Sales | Combined<br>Sales | T1<br>%<br>Allocation | T3<br>%<br>Allocation |      |
|---------------|------------------------|--------------------------|-------------------|-----------------------|-----------------------|------|
| Sep-05        | 90,202.40              | 51,655.23                | 141,857.63        | 64%                   | 36%                   | 100% |
| Oct-05        | 92,976.93              | 50,575.03                | 143,551.96        | 65%                   | 35%                   | 100% |
| Nov-05        | 90,297.47              | 50,090.67                | 140,388.14        | 64%                   | 36%                   | 100% |
| Dec-05        | 103,072.76             | 60,073.56                | 163,146.32        | 63%                   | 37%                   | 100% |
| Jan-06        | 84,786.45              | 51,622.08                | 136,408.53        | 62%                   | 38%                   | 100% |
| Feb-06        | 79,512.72              | 45,582.58                | 125,095.30        | 64%                   | 36%                   | 100% |
| Mar-06        | 0.00                   | 0.00                     | -                 |                       |                       |      |
| Apr-06        | 0.00                   | 0.00                     | -                 |                       |                       |      |
| May-06        | 0.00                   | 0.00                     | -                 |                       |                       |      |
| Jun-06        | 0.00                   | 0.00                     | -                 |                       |                       |      |
| Jul-06        | 0.00                   | 0.00                     | -                 |                       |                       |      |
| Aug-06        | 0.00                   | 0.00                     | -                 |                       |                       |      |
| Total To Date | 540,848.73             | 309,599.15               | 850,447.88        |                       |                       |      |

**Monthly Percentage Rent Calculation:**

|                                       |     | Sales             | Percent           | T1<br>Sales<br>Allocation | T3<br>Sales<br>Allocation | Total            |
|---------------------------------------|-----|-------------------|-------------------|---------------------------|---------------------------|------------------|
| up to \$750,000                       | 8%  | 24,647.42         | 1,971.79          | 1,253.31                  | 718.49                    | 1,971.79         |
| \$750,000 up to \$1,200,000           | 10% | 100,447.88        | 10,044.79         | 6,384.64                  | 3,660.15                  | 10,044.79        |
| > \$1,200,000                         | 12% | -                 | -                 | -                         | -                         | -                |
| <b>Total Current month</b>            |     | <b>125,095.30</b> | <b>12,016.58</b>  | <b>7,637.95</b>           | <b>4,378.64</b>           | <b>12,016.58</b> |
| Less minimum monthly - BK/Gate74      |     |                   | (3,340.00)        | (3,340.00)                |                           |                  |
| Less minimum monthly - BK/Mezz        |     |                   | (2,720.00)        |                           | (2,720.00)                |                  |
| Balance due and remitted herewith --> |     |                   | <b>\$5,956.58</b> | <b>4,297.95</b>           | <b>1,658.64</b>           | <b>5,956.58</b>  |



Annual Report of Gross Revenue

XYZ, Inc. / XYZ Restaurant

(Company Name / Facility Name)

| Month        | Year <u>2000</u>  | Year <u>2001</u>      | Year <u>2002</u>      |
|--------------|-------------------|-----------------------|-----------------------|
| January      |                   | \$555,555.00          | \$111,111.00          |
| February     |                   | \$333,333.00          | \$111,111.00          |
| March        |                   | \$222,222.00          | \$100,000.00          |
| April        |                   | \$111,111.00          | \$122,222.00          |
| May          |                   | \$999,999.00          | \$222,222.00          |
| June         |                   | \$888,888.00          | \$333,332.00          |
| July         |                   | \$222,222.00          | \$111,111.00          |
| August       |                   | \$444,888.00          | \$555,555.00          |
| September    |                   | \$999,000.00          | \$666,666.00          |
| October      |                   | \$111,999.00          | \$777,777.00          |
| November     | \$225.00          | \$111,222.00          | \$222,222.00          |
| December     | \$1,000.00        | \$111,000.00          | \$999,999.00          |
| <b>Total</b> | <b>\$1,225.00</b> | <b>\$5,113,440.00</b> | <b>\$4,335,330.00</b> |

Jane Smith, CFO

CPA or CFO of Company \*

Sample Only

Report Sample

\* Report must be certified by Company's CPA (Certified Public Accountant) or by its CFO (Chief Financial Officer).

## Annual Report of Gross Revenue

SFO Equities, LLC      Burger King Locations      Terminal 3  
(Company Name / Facility Name)

| Month     | Year 2004  | Year 2005    | Year 2006 |
|-----------|------------|--------------|-----------|
| January   | not opened | 123,279.65   |           |
|           |            | 79,577.37    |           |
| February  | not opened | 111,902.02   |           |
|           |            | 66,275.59    |           |
| March     | not opened | 127,861.30   |           |
|           |            | 70,043.41    |           |
| April     | not opened | 110,340.94   |           |
|           |            | 59,828.30    |           |
| May       | not opened | 120,167.74   |           |
|           |            | 61,087.77    |           |
| June      | not opened | 123,362.10   |           |
|           |            | 65,543.47    |           |
| July      | not opened | 126,919.87   |           |
|           |            | 67,687.57    |           |
| August    | not opened | 115,591.18   |           |
|           |            | 65,231.70    |           |
| September | 46,051.20  |              |           |
|           | 94,237.60  |              |           |
| October   | 124,143.47 |              |           |
|           | 88,978.58  |              |           |
| November  | 134,213.42 |              |           |
|           | 77,538.65  |              |           |
| December  | 135,901.49 |              |           |
|           | 91,083.51  |              |           |
| Total     | 792,147.92 | 1,494,699.98 | 0.00      |

*Pamela D. Bellon*  
CPA of CFO of Company \*

\* Report must be certified by Company's CPA (Certified Public Accountant) or its CFO (Chief Financial Officer).

*Copy of this report  
submitted separately*



