CHARLOTTE.

INTERNAL AUDIT

Audit Report
Airport Rental Car Concession Agreements
Advantage
January 24, 2018

City Auditor's Office
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Purpose and Scope

The primary objectives of this audit were to determine whether Advantage Rent A Car, LLC (Advantage):

- Accurately reported gross revenues; computed and paid monthly concession fees, complying with payment guarantee and annual certification requirement provisions
- Accurately reported and paid Contract Facility Charge (CFC) payments

In addition to the above primary objectives, the audit was conducted to determine whether the Airport has properly designed and implemented internal controls, including effective contract terms.

An audit of rental car concession agreements was requested by Aviation management. Auditors selected Advantage and reviewed gross revenues for FY17.

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.

This report is intended for the use of the City Manager's Office, City Council, and the Aviation Department.

Conclusion

Advantage accurately reported concession revenue and CFC fees to the Charlotte Douglas International Airport.

Summary of Findings and Recommendations

1. Advantage accurately reported concessions and CFCs to the Charlotte Douglas International Airport.

    - Aviation has implemented a new monthly reporting form requiring rental car agencies to identify revenue by category and to provide detail on amounts identified as "excluded revenue." The new form is now in place for FY18.

2. Aviation should consider insurance as part of gross revenue when negotiating future contractual agreements.

    - At the next car rental concession agreement opportunity, Aviation will consider having insurance included as an item subject to the 10% concession fee. However, due to the current negotiation climate it is unlikely that this change will be required of the rental car agencies in the near future.

Background

Rental car activites at the Charlotte Douglas International Airport represent one of the largest generators of Airport revenues. Given the importance of this business unit, the Aviation Department requested that Internal Audit review contract compliance of rental car companies on a rotating basis. Advantage was selected as it is one of the last agencies yet to be reviewed.

On-Airport Automobile Concession Agreements (Agreements) were awarded to eight rental car agencies on November 1, 2000, for a period of seven years. The Agreements have been amended periodically, most recently in November 2011, and are scheduled to expire in 2024. The purpose of the Agreements is to provide passenger vehicle rentals to Airport users. Each Agreement requires the Concessionaire to pay the City the greater of ten percent (10%) of the Concessionaire's Gross Revenues during each contract year, or eighty five percent (85%) of Concessionaire's total concession fees payable during the immediately preceding contract year ("Minimum Annual Concession Fee").

The concessionaires are required to pay one-twelfth of the minimum annual concession fee in advance each month. Within 25 days of each calendar month-end, each concessionaire is required to provide Aviation with an accounting of its year-to-date gross revenues and pay the difference between the amount of the calculated annual percentage fee and the total of previous payments. Annually, within 90 days following contract year-end, each concessionaire is required to furnish a statement (certified to be correct by an authorized representative) of gross revenues for the preceding year, showing authorized deductions or exclusions made in computing the amount of such gross revenues. Aviation collected $14.4 million in concession fees in FY17 from $143.7 million in reported gross revenue, as the Aviation-generated summary details in the graph on the next page.

In addition, the City imposed by ordinance effective July 1, 2007 (CFC Ordinance) a charge to be collected from rental car customers at the Airport, the proceeds of which are used to pay the costs of planning, designing, constructing, financing, maintaining and operating new consolidated rental car facilities at the Airport. Rental car agencies are required to collect a Contract Facility Charge (CFC) equal to $4.00 per transaction day and deposit the fees collected with a Trustee on or before the tenth day of the immediately succeeding month. Aviation collected about $12.9 million in CFC fees in FY17, also detailed in the graph below:

Charlotte Douglas International Airport
Rental Car Fees
Fiscal Year 2017

Company	Concession Fee	CFC's Collected
Avis	$ 2,426,333	$ 2,032,868
Budget	1,363,719	1,265,984
Dollar	749,513	856,428
Enterprise	2,161,525	1,720,449
Hertz	4,307,348	2,761,184
National	3,062,902	3,949,244
Advantage	306,454	312,014
Total	$ 14,377,794	$ 12,898,171

Audit Findings and Recommendations

1. ***Advantage accurately reported concession revenue and CFCs to Charlotte Douglas International Airport.***

According to the concession agreements, gross revenues include all monies or other consideration paid or payable to Concessionaire for all sales made and services performed in connection with automobile and vehicle rentals. Gross Revenues specifically include all of the following:

- Revenue earned for the rental or sale of wireless communication devices, mobile telephones, computerized navigation equipment and services and similar services of whatsoever nature;
- Revenue earned from the rental of child/infant car seats or restraints, ski racks, bicycle racks, recreational gear, personal computers and facsimile machines

The agreements specifically exclude federal, state, county, city or municipal sales, use or excise taxes; any charges collected from customers for refueling an automobile rented pursuant to an agreement under which the customer is obligated to return the automobile with the same amount of gasoline furnished upon rental; and all amounts paid or payable by customers for acceptance of a collision damage waiver, personal effects coverage or other insurance products.

Auditors noted that Advantage accurately reported concession revenue and CFC fees for FY17. Auditors obtained, summarized and audited detailed rental transaction data and noted that the data agreed to monthly revenue reported to Aviation and no material exceptions were noted with the categorization of included income items. However, auditors noted that Aviation did not have a control in place to review excluded revenues for proper classification during FY17. Aviation requires that rental car agencies submit a "Gross Revenue Worksheet" each month. The form shows the 10% concession fee calculation and requires the disclosure of the actual number of contracts reflected in the gross revenue figure, but does not require the identification of revenue that was excluded from the concession fee calculation. During previous rental car reviews, auditors recommended that Aviation implement a new monthly reporting form to assist in the identification of revenue items that are improperly excluded from concession revenue.

Action Taken

Aviation has implemented a new monthly reporting form requiring rental car agencies to identify revenue by category, and to provide detail on amounts identified as "excluded revenue." The new reporting form was introduced to the rental car agencies during negotiations to clarify and restate the current agreements and is now being used in FY18 to report gross revenue and concession fees. Auditors will review the adequacy of the form during future rental car audits.

2. *Aviation should include insurance as part of gross revenue when negotiating future concession agreements.*

The concession agreement excludes all revenue amounts paid or payable to Aviation for acceptance of a collision damage waiver (CDW), a loss damage waiver (LDW), or insurance including personal effects coverage (PEC), cargo, life insurance, supplemental liability insurance, or other insurance offered to customers now or in the future.

This creates a risk that rental car agencies can use pre-paid, corporate and/or bundled rental rates to allocate a disproportionate share of rental revenue to the concession fee "excluded" insurance categories. The result would be an understatement of gross concession revenue. Auditors reviewed Advantage car rental transactions to determine whether a disproportionate share of low dollar rental transactions had associated "excluded" insurance revenue. This would potentially indicate an intentional "shifting" of rental income to the "excluded" category. Auditors noted:

- There were 6,769 vehicles rented for a base (time and mileage components) daily rental rate of less than $25 per day. Loss Damage Waiver (LDW) insurance was purchased for 696 (10.2%) of these rentals. The total insurance costs exceeded the base rental rate in more than 98% of these agreements.

- In the $25-$50 base daily rental rate category, there were 11,373 rentals, with 1,633 (14.35%) of them purchasing the LDW insurance.

Because the percent (10.2%) of low-dollar base rental agreements that included insurance was lower than the percent (14.35%) of agreements in the $25 to $50 base rental range, auditors concluded that the risk of intentional shifting of costs was relatively low. However, the possibility exists that the number and amount of low-dollar base rental transactions with insurance will increase over time. To decrease risk, Aviation should remove the opportunity for rental companies to benefit from any reallocation, or shifting, of revenue between categories. One way of accomplishing this is to require that insurance items be categorized as "included" revenue. Auditors contacted 25 nationwide airports to see whether they consider insurance as included or excluded revenue in their rental car concession agreements. Only Charlotte Douglas and Bozeman Yellowstone International Airport exclude insurance fees in the calculation of concession revenue. The list of 25 airports included the following 15 airports that ranked in the top 40 of airports nationwide:

Austin-Bergstrom International
Boston Logan International
Denver International
George Bush Intercontinental
John Wayne Airport (Santa Ana, CA)
McCarran International (Las Vegas, NV)
Metropolitan Washington Airports (Dulles and Reagan)
Minneapolis-St. Paul International
Nashville International
Orlando International
Port of Seattle
Portland International
Raleigh Durham International
San Francisco International
Tampa International

In the past, auditors have recommended that Aviation periodically request supporting detail for rental transactions. This would allow management to identify any trend within a specific rental car agency that would indicate a need for further review, e.g., a significant increase in the percentage of rental agreements with excluded insurance revenue. While Audit still recommends that additional data be collected, we recognize that Aviation has already negotiated with rental car companies to provide an increased level of detailed reporting, and we agree that further requests can await the next round of contract negotiations.

Recommendation: Aviation should include insurance as a gross revenue item subject to the 10% concession fee.

<u>Aviation Response:</u> At the next car rental concession agreement opportunity, Aviation will consider having insurance included as an item subject to the 10% concession fee. However, due to the current climate it is unlikely that this change will be required of the rental car agencies in the foreseeable future.