Audit Report
Airport Advertising Concession FY17
October 25, 2018

City Auditor's Office
Gregory L. McDowell, CPA, CIA

Audit Report
Airport Advertising Concession FY17
October 25, 2018

Purpose and Scope

The purpose of this audit was to determine whether the advertising concession agency accurately reported net revenues; computed and paid monthly concession fees, and complied with payment guarantee and annual certification requirement provisions. In addition, the audit was conducted to determine whether the Aviation Department (Aviation) has properly designed and implemented internal controls, including effective contract terms.

An audit of the advertising concession agreement was requested by Aviation management. The agreement is with Intersection Media, LLC (Intersection), formerly known as Titan Outdoor LLC. Auditors focused the review on net revenues for FY17, and also performed a brief review of FY18 revenues for comparison purposes.

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 Aviation.

Conclusion **–** Controls adopted as a result of the audit will guard against unreported revenue, while improving the efficiency of contract administration efforts.

Summary of Findings and Recommendations

The following findings are detailed, beginning on page 2:

1. ***Aviation should establish additional controls to ensure all advertising revenue is reported.***
   - Aviation recognizes the importance to ensure all revenue is accounted for and will work to improve revenue reporting by the advertising concessionaire.
2. ***Additional contract administration controls should be considered in the future.***
   - Aviation has recently hired a Concession Revenue Analyst and plans to hire a Concessions Contract Manager to assist the Aviation Concessions Manager in managing this contract.

Background

Advertising Concession activities at the Charlotte Douglas International Airport (CLT) generated $2.6 million in revenue for FY17 and $4 million for FY18. Charlotte Douglas International Airport solicited in 2013 for a contractor to develop and oversee advertising concessions. CLT required proposers to estimate revenue per enplanement (RPE), and to propose a percentage of gross revenue to be paid, which would be used to calculate the Minimum Annual Guarantee (MAG). MAGs are typically established in such concession contracts to determine monthly payments, followed by a year-end reconciliation if actual revenues result in a higher annual payment to the Airport.

The Advertising Concession agreement was awarded to Intersection effective August 1, 2013 and expiring June 30, 2018. The agreement required the concessionaire to pay the City the greater of the MAG or sixty five percent (65%) of static displays net revenue and fifty five percent (55%) of digital displays net revenue. In addition, Intersection made an initial capital investment of $1.5 million for advertising display improvements.

Within 30 days of each concession year-end, the concessionaire is required to pay the City a reconciliation amount if the airport share of net revenues earned during the year exceeded the MAG. The concessionaire is also required to submit an independent CPA's report that the concession fee paid to the City during the preceding year complied with the terms of the agreement.

In January 2018, the City entered into a new five-year advertising agreement with Intersection which requires the company to make an additional $1.1 million investment in capital improvements. The City has the option of extending the agreement after June 30, 2023 for an additional five years.

Audit Findings and Recommendations

1. Aviation should establish additional controls to ensure all advertising revenue is reported.

Intersection provided monthly billing summaries detailing Aviation's static and digital revenue share, along with the calculated MAG payment. The concessionaire submitted these payments timely and paid the correct annual reconciliation amount in accordance with the agreement, which was also substantiated by a CPA's report. However, Aviation should establish additional controls to assist in the detection of any unreported revenue.

The contract requires that Intersection determine rates that are competitive with comparable facilities. It must establish a rate schedule, which is to be approved in writing by the City.

The agreement requires the concessionaire to offer unsold space to the City at no cost. Aviation has not established an effective method to periodically inventory sold advertising space and reconcile to reported revenue. Records obtained by auditors indicate that no revenue was derived from 107 (37%) of the available 288 media-months in FY17 (i.e., 24 media types for 12 months each). Review of FY18 noted 47% of spaces with no revenue.

For Aviation to be aware and benefit from unsold spaces, a process needs to be established that accounts for revenue received from all media types. In addition, the lack of effective controls could result in unreported revenue that is not detected, or which is not in compliance with the rate-setting contract requirements.

Recommendation: Aviation should maintain an inventory of available advertising concession spaces, periodically record advertisers using the space, and subsequently compare its records to the monthly revenue detail summary received from Intersection. Any unreported revenue for spaces in use should be addressed to the contractor to determine the cause of discrepancy.

Aviation Response: Aviation agrees with the need to track unused advertising space and has directed Intersection to identify all unsold space in its periodic reporting.

2. Additional contract administration controls should be considered in the future.

Aviation has been satisfied with Intersection's fulfillment of the contract. Specifically, the Minimum Annual Guarantee (MAG) has been paid according to terms, and the required annual reconciliation payment has been received timely. Also, Intersection has submitted CPA audits and maintained a letter of credit to protect the City's financial interests.

Three additional steps could be taken to further protect or enhance the Airport's revenues.

A. The reasonableness of production and installation expenses, which may offset reported revenue, could be monitored.
B. Agency Fees (allowed up to 15% of revenue) could be reported and monitored.
C. The MAG could be structured to obtain higher monthly revenue, and reduce the annual reconciliation payment.

A. Production and Installation Expenses

Aviation does not require Intersection to disclose production and installation costs, which are excluded from revenue shared with the Airport. Disclosure would allow Aviation to monitor the reasonableness of such costs and help determine that revenue is not shifted to non-shareable expenses.

Article 5 – Records and Audit – allows Aviation to obtain this information upon request. However, this information could be included with the monthly revenue detail summary already provided by the concessionaire, to allow for regular monitoring.

Internal Audit obtained documentation from Intersection which indicates that production and installation costs equaled 5% of reported revenue in FY17. One advertising agreement auditors examined had a 16% exclusion for these costs. Due to individual media contracts, auditors could not determine whether 5% overall or 16% specifically are reasonable. However, there would be a benefit to the airport to receive this information for all new advertising contracts. Aviation staff would then be able to follow-up more timely to review supporting documentation for any outliers, as they deem appropriate.

B. Agency Fees

The contract allows up to 15% of revenues to be excluded as a part of calculating Net Revenues, which are shared per formula (65% of static and 55% of digital displays). The CPA audit states only that agency fees have been deducted from total revenues.

Article 5 – Records and Audit – allows Aviation to obtain this information upon request. However, this information could be included with the monthly revenue detail summary already provided by the concessionaire, to allow for monitoring.

C. Minimum Annual Guarantee Payments

Each year, the MAG is determined by contractual formula. For the four years ended June 2018, Intersection made monthly payments totaling $1.58 million to $1.63 million per year. In those same years, the annual reconciliation payments ranged $729 thousand to $3.7 million, with the most recent payment of $2,367,611 – more than the FY18 MAG of $1,615,459.

A MAG which is closer to expected total revenues would result in improved cash flow, along with potential interest revenue. In the past four years, the airport received reconciliation payments totaling over $4.4 million. The airport would have benefited by receiving a portion of that amount monthly.

Recommendations: Additional contract administration controls should be considered in the future. Production and installation expenses, along with Agency Fees should be monitored, and the annual CPA report should include detailed disclosures of the amounts. Also, MAGS should be structured to achieve a higher expected percentage of annual concession fees. (For example, contracts could be structured to annually adjust the MAG to equal a percentage of the prior year actual.)

Aviation Response: Aviation will consider additional contract controls on future advertising concession contracts. Aviation has recently hired a Concession Revenue Analyst and is working on hiring a Concessions Contract Manager to assist the Concessions Manager.