CATS Advertising Revenue Contract

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CATS Advertising Revenue Contract Audit Executive Summary

Objective

This audit was conducted to assess controls related to transit advertising revenue processes and determine whether amounts due under the advertising agreement have been accurately reported, billed and collected.

Background

In March 2016, the City issued a Request for Proposal (RFP) for the Advertising Revenue Program. The revenues were intended to help defray operating costs and lessen the amount of fare increases.

CATS selected Vector Media Holding Corporation (formerly Direct Media, Inc). The five-year contract provided for a guaranteed minimum revenue (GMR) of $7.8 million plus a percentage share of revenue in excess of the GMR.

Conclusion

CATS did not implement internal controls to ensure that all amounts due under the advertising concession agreement were accurately reported, billed, and collected.

Highlights

CATS and Vector interpreted revenue sharing contract language differently.

- Detected by CATS in 2020 when Vector asked for relief from payments because of the economic impact of the coronavirus pandemic
- CATS and the City Attorney's Office are working with the vendor to resolve the issue

CATS did not establish controls to verify all advertising revenue was accurately reported.

CATS should:

- reconcile advertising revenue in a timely manner
- perform an independent confirmation of reported advertising revenue
- obtain copies of contracts between Vector and advertisers and Vector's annual audited financial statements

CATS did not establish a system to track the performance of the advertising revenue vendor.

CATS should establish specific expectations or goals for:

- advertising utilization
- production/ installation costs
- average revenue per media type

Actions Planned

CATS is evaluating the option to bring the advertising program in-house. Should CATS decide to contract for advertising services in the future, it has agreed to implement the recommendations in this report.

Contents

Background

The Charlotte Area Transit System (CATS) provides community-wide public transportation services with a fleet of 314 buses and 42 light rail vehicles. CATS operates the largest transit system between Washington, D.C. and Atlanta and in FY 2019 served 72,678 weekday daily trips. The Metropolitan Transit Commission (MTC) is the transit governing board for CATS. Its primary function is to approve transit policy and budgets.

In March 2016, the City issued a Request for Proposal (RFP) for the Advertising Revenue Program. The revenues from this program are intended to help defray operating costs and lessen the amount of fare increases.

In September 2016, MTC approved the Transit Advertising & Sponsorships Policy (MTC-07). This policy authorizes CATS to "sell space in and/or on approved assets for the display of commercial or governmental advertising." The policy details assets that may display paid advertisements and types of prohibited advertising.

CATS selected Direct Media, Inc, and signed a three-year contract with two one-year renewal options in August 2016. The contract provisions included a guaranteed minimum revenue (GMR) plus a percentage share (60% for the first three years, 63% thereafter) of revenue in excess of the GMR. The total GMR for the entire five years equaled $7,801,000. Vector Media Holding Corporation (Vector) later acquired Direct Media. This ownership change was acknowledged by the City in a 2019 amendment to the contract when the first renewal option was exercised.

Objective

This audit was conducted to assess controls related to transit advertising revenue processes and determine whether amounts due under the advertising agreement have been accurately reported, billed, and collected.

Scope, Methodology, and Compliance

Scope

This audit was requested by CATS during the annual audit planning meeting and focused on CATS' contract with Vector Media for advertising revenue services from August 2016 through July 2021.

Methodology

To achieve the audit objectives, auditors performed the following:

- Reviewed the advertising revenue contract between CATS and Vector,
- Interviewed CATS Finance and Marketing staff,
- Reviewed advertising revenue recorded on the City's general ledger,

- Reviewed CATS' reconciliation of advertising revenue,
- Reviewed monthly sales activity reports provided by Vector,
- Reviewed 14 advertisers' contracts with Vector,
- Analyzed the guaranteed minimum revenue provisions in the advertising contract, and
- Assessed the design effectiveness of CATS' advertising revenue controls.

Compliance

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.

Government auditing standards require that we determine which internal controls are material to the audit objective and obtain an understanding of those controls. To evaluate internal controls, the City Auditor's Office follows the Committee of Sponsoring Organizations of the Treadway Commission's Internal Control – Integrated Framework (COSO Framework) as included in Standards for Internal Control in the Federal Government (GAO Green Book).

In planning and performing the audit, auditors obtained an understanding of the processes used by CATS related to advertising revenue and the associated internal controls; assessed the internal control risks; and determined the following COSO internal control components were significant:

- Control Activities – The actions management establishes through policies and procedures to achieve objectives and respond to risks.
- Monitoring Activities – The activities management establishes and operates to assess the quality of performance over time.

CATS did not maintain an independent record of advertisements during the audit period. Therefore, it could not be determined whether Vector reported all revenue earned. It is possible that advertisements were placed on CATS' assets but not reported by Vector. Without an independent record of prior advertisements, it is not possible to determine if any revenue was unreported.

Auditors noted that the key internal control (reconciliation of revenue) was not performed until the end of the contract. The internal control deficiencies that are significant within the context of the audit objective are discussed in the Findings and Recommendations section of this report. For additional information regarding internal control components and the related principles of internal control, please see Appendix A.

Findings and Recommendations

1. *CATS and Vector interpreted revenue sharing contract language differently.*

The advertising revenue contract specified that Vector owed the GMR monthly and the shared revenue obligation quarterly. Contract language (Section 3.2) states:

> *"under no circumstances will the Shared Revenue Payment reduce the monthly Guaranteed Revenue Payment to the City. However, during the same contract year a Shared Revenue Payment may be used to offset any reduction in revenue below the Guaranteed Revenue Payments made for the following quarter."*

CATS and Vector interpreted contract language differently for determining revenue due to the City. Starting in 2016, Vector provided CATS a yearly summary report calculating quarterly payments due to the City which showed their methodology was the greater of the GMR **or** the percentage of shared revenue. CATS interpretation was that ***in addition to*** the GMR, the percentage of shared revenue in excess of the GMR was due. In months when there was a revenue shortfall (i.e. total revenue < GMR), CATS deducted 100% of the deficit from revenue due.

This difference in interpretation of contract terms was not detected by CATS until 2020 when Vector asked for relief from payments because of the economic impact of the coronavirus pandemic. This request was denied, and CATS began discussions with Vector towards resolution of the final payment due to the City.

Recommendation: CATS should recover funds due from Vector based upon the agreed interpretation of the shared revenue contract language.

Value Added: Compliance; Cost Savings

CATS Response: Agree. CATS' CFO, Director of Marketing and Communications (Project Manager), and City Attorney's Office are actively pursuing Vector to recover any funds due.

2. *CATS did not establish controls to verify all advertising revenue was accurately reported.*

The following internal control deficiencies were noted:

- CATS did not reconcile advertising revenue in a timely manner.

  Although CATS' accounts receivable staff reviewed monthly billings to ensure guaranteed revenue payments were received, CATS did not perform monthly reconciliations of advertising revenue during the early term of the contract. Instead, CATS prepared a "true-up" reconciliation at the end of FY 2020 based on its interpretation of the revenue sharing agreement and continued to update this reconciliation through the end of the contract.

Payment discrepancies could have been addressed earlier in the contract if a timelier reconciliation of receivables and revenue had been performed.

- CATS did not perform an independent confirmation of reported advertising revenue and relied on Vector's self-reporting.

  As contractually required, Vector provided monthly reports listing the name and gross billings for each advertiser and a summary report of total gross billings. CATS did not have a process to verify the accuracy of Vector's self-reported advertising activity. Without an independent verification of advertising activity, it is not possible to determine if Vector reported all advertising revenue and that the City received all shared revenue due.

- CATS did not obtain copies of contracts between Vector and advertisers and Vector's annual audited financial statements.

  Although Vector was contractually required to provide copies of all advertisers' contracts to the City, CATS did not request or obtain the agreements. The June 2021 Monthly Advertising Report listed a total of 85 advertisers during the fifth and final contract year (August 2020 – July 2021). As of the end of Vector's contract, CATS had not received copies of any advertisers' contracts. Upon request by CATS for all contract copies, Vector provided copies of 14 active contracts as of July 2021.

  Vector was also required to provide annual audited financial statements, including a separate statement verifying "the truth and accuracy of statements of revenue and account receivables." CATS could use this information to validate reported revenue and obtain a better understanding of the advertising market. CATS did not receive or review any of Vector's annual audited financial statements.

Recommendation 2a: CATS should perform monthly reconciliations of advertising revenue billing and receipts to ensure that contractual payments are made.

Value Added: Compliance; Risk Reduction

CATS Response: Agree. Previous Marketing & Communications staff held monthly meetings with Vector to discuss the monthly sales and trends. During that time, the monthly amount due from Vector was validated and confirmed. In 2019, the current Marketing & Communications staff met with Vector to discuss upcoming contracts, market trends, and any issues with current contracts.

In the future, should CATS decide to contract the services, the Project Manager and CATS' Manager of Accounting Operations will coordinate monthly and/or quarterly with the selected vendor to review their reporting of advertising clients, contracts, and revenue to ensure completeness and accuracy based on the clearly defined terms of the contracts.

Recommendation 2b: CATS should establish a process to independently verify the accuracy of advertising revenue reported by the vendor. Possible methods of independent verification include, but are not limited to, comparison of the advertising on buses with the monthly advertising sales reports, confirmation with advertisers, comparison of reported sales activity to individual advertising contracts and/or reviewing of Vector's audited financial reports.

Value Added: Compliance; Risk Reduction

CATS Response: Should CATS decide to contract the Transit Advertising Services in the future, the CATS' staff will develop processes that allow confirmation of advertising on vehicles as reported on sales reports and advertiser contracts. This would include conducting random field checks for a percentage of advertising contracts to confirm the details.

In coordination with CATS Marketing project manager, the Manager of Accounting Operations will review the contracted agency's audited financial reports annually for reasonableness in comparison to revenue reported to CATS. The appropriate calculations and reconciliations would be performed to confirm the revenue is accurately reported. If it is not, clarification could be sought immediately.

Recommendation 2c: CATS should ensure copies of all advertisers' contracts are received in a timely manner and reviewed to verify revenue is properly reported. CATS should also develop a process to monitor the receipt and review of audited financial statements from Vector as contractually required.

Value Added: Compliance; Risk Reduction

CATS Response: Agree. Should CATS decide to contract the Transit Advertising Services in the future, the CATS' Marketing Project Manager will implement procedures to ensure copies of contracts are provided to CATS upon execution. In addition, CATS Marketing project manager and Manager of Accounting Operations will review the contracted agency's audited financial reports annually for reasonableness in comparison to revenue reported to CATS. If deemed appropriate, CATS will request an independent audit of the advertising agency's financial records.

3. CATS did not establish a system to track the performance of the advertising revenue vendor.

Vendor performance management is a critical aspect of strategic sourcing – it helps ensure that the City is getting what it needs and wants out of its investment in choosing and contracting with the ideal vendor. One of the first steps in effective vendor performance reviews is establishing key performance indicators designed to measure the quality, delivery, service, and stability of the vendor.

While the revenue sharing agreement establishes a minimum service level expectation in respect to revenue, CATS has not established more specific expectations or goals for the advertising vendor's performance. These could include goals related to advertising utilization, production/ installation costs, and average revenue.

Utilization

The Scope of Services in the contract made several types of assets available to generate paid advertising:

- Exterior ads on any revenue vehicles
- Interior ads on any revenue vehicles
- Ads on printed schedules
- Ads on ticket stock for the light rail system
- Rail platform signage, where permitted by local ordinances
- Concessions on platform where conduit is readily available
- CATS Parking decks and other facility assets, where permitted by local ordinances
- Naming rights and sponsorships

CATS Marketing held monthly meetings with Vector to discuss account activity but did not establish a method to monitor inventory utilization and revenue expectations. During the fifth contract year (August 2020 – July 2021) the primary advertising inventory utilized were the exterior and interior ads on revenue vehicles. In that period, only one advertiser placed another type of ad, a bus station banner.

Vector's May 2021 advertising report indicated that 123 buses (39%) of the 314 available had paid advertisements. All 42 light rail vehicles (100%) were reported as having paid advertising for the same period. Measuring progress towards meeting established goals and expectations is necessary to assess vendor quality. Since CATS had not established any specific goals, the 39% utilization rate for bus advertisements could have exceeded or fell short of expectations.

Production and Installation Costs

The advertising contract with Vector included terms specifying advertisers' contracts should itemize all pertinent information required by the City to maintain complete knowledge of all advertising being displayed on CATS' assets and related costs. This included production charges and a detailed explanation of any variance in the price shown on the contract from Vector's current published advertising rates. As discussed in Finding 2 above, CATS had not been receiving copies of advertisers' contracts which would have allowed for review and monitoring of this information. Production costs were also not included on the monthly sales report Vector provided to the City. Production costs were listed on two of the 14 advertisers' contracts that CATS received at the end of the contract. Without knowledge and periodic analysis of these costs, the risk exists that a vendor could over-charge advertisers for production and installation costs (non-CATS revenue) in exchange for lower media rates (CATS revenue).

Average Revenue

Review of the 14 advertisers' contracts indicated that Vector sometimes offered customers "bonus" advertisement placements at no-cost. Per CATS Marketing, some advertising companies will offer these types of incentives "to get or keep the business if the inventory allows." Of the 710 ad placements (per the 14 reviewed contracts), advertisers received 403 (57%) at no-cost. The duration of the bonus ads ranged from one day to 13 months (average 5.9 months). Based on the average monthly cost for similar ad types from these contracts, the potential monthly revenue from these advertisements was approximately $123,620. CATS' share could be up to 63% ($77,880) of this amount, depending on the monthly GMR calculations.

Ad Type	# Bonus Ads	Average Monthly Cost per Ad	Potential Total Monthly Revenue
Bus			
Full Backs	2	$ 785	$ 1,570
Full Wrap	1	6,000	6,000
Headliners	16	*	-
Interior Cards	150	*	-
King	67	381	25,527
Kongs	75	445	33,375
Super Impact Tail	48	246	11,808
Ultra-Super King	33	880	29,040
	392	8,737	107,320
Light Rail			-
Full Wrap	1	5,000	5,000
King	4	200	800
King Kong	6	1,750	10,500
	11	6,950	16,300
Total Bonus Ads	**403**	**$ 15,687**	**$ 123,620**

**Note: No information available for cost comparison.*

These bonus advertisements were not included on the monthly sales report. Without having obtained copies of the contracts, CATS was unaware of these bonus ads and could not calculate an accurate revenue per advertisement type or asset (bus, light rail, etc.) value. Since the City receives a percentage of gross sales in excess of the GMR, no-cost ads reduce the revenues received by the City and lower average revenue per advertisement type or asset.

Contract administration and vendor management is improved when expectations are established, and vendor performance is measured.

Recommendation 3: CATS should maximize potential revenue by establishing expectations (e.g., percentage utilization; production and installation costs; revenue per advertisement type, revenue per asset) and measuring vendor performance.

Value Added: Cost Savings; Compliance

CATS Response: Agree. Should CATS decide to contract the Transit Advertising Services in the future, the CATS' Marketing Project Manager will consider other opportunities to maximize potential revenue. This is one of the reasons why CATS' CEO is considering bringing this function in-house. The objective of which is to receive 100% of the revenue, reimbursement of production and installation costs, and a more cost-effective streamlined process.

Conclusion

CATS did not implement internal controls to ensure that all amounts due under the advertising concession agreement were accurately reported, billed, and collected.

Distribution of Report

This report is intended for the use of the City Manager's Office, City Council, and all City departments. Following issuance, audit reports are sent to City Council and subsequently posted to the Internal Audit website.

Appendix A

The Five Components and 17 Principles of Internal Control

Component	Principles
Control Environment	1. The oversight body and management should demonstrate a commitment to integrity and ethical values. 2. The oversight body should oversee the entity's internal control system. 3. Management should establish an organizational structure, assign responsibility and delegate authority to achieve the entity's objectives. 4. Management should demonstrate a commitment to recruit, develop and retain competent individuals. 5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.
Risk Assessment	6. Management should define objectives clearly to enable the identification of risks and define risk tolerances. 7. Management should identify, analyze, and respond to risks related to achieving the defined objectives. 8. Management should consider the potential for fraud when identifying, analyzing and responding to risks. 9. Management should identify, analyze and respond to significant changes that could impact the internal control system.
Control Activities	10. Management should design control activities to achieve objectives and respond to risks. 11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks. 12. Management should implement control activities through policies.
Information & Communication	13. Management should use quality information to achieve the entity's objectives. 14. Management should internally communicate the necessary quality information to achieve the entity's objectives. 15. Management should externally communicate the necessary quality information to achieve the entity's objectives.
Monitoring	16. Management should establish and operate a monitoring mechanism that monitors both internal and external activities that impact the control system and evaluate the results. 17. Management should remediate identified internal control deficiencies on a timely basis.