# INTERNAL AUDIT REPORT

## RENTAL CAR CONCESSION AGREEMENT AUDIT
## Avis Budget Group dba Avis Budget Car Rental

June 01, 2013 – May 31, 2016

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# EXECUTIVE SUMMARY

Internal Audit (IA) completed a rental car concession audit of Avis Budget Car Rental (Avis Budget) for the period June 01, 2013 – May 31, 2016. The audit was performed to determine whether Port management monitoring controls were effective and to assure that: Avis Budget reported Concession Fees were complete, properly calculated, and remitted timely to the Port; that Avis Budget complied with significant financial provisions of the Concession Agreement (CA), as amended; and that the Customer Facility Charge (CFC) was properly collected and remitted.

We concluded that management controls were effective to assure the reported concession fees were materially complete, properly calculated, and remitted timely to the Port of Seattle (Port). We also concluded that Avis Budget materially complied with the terms of the CA with one exception:

- Avis Budget was unable to provide us with details regarding adjustments made to customer bills. This led us to conclude that Avis Budget did not maintain the details of adjustments in their recordkeeping systems. Certain adjustments to revenue could be disallowed resulting in an understatement of revenue and the related concession fee paid to the Port. Additionally, this issue was a repeat finding that was identified in a prior internal audit of Avis Budget Group, LLC Audit (Report No. 2012-20). Internal Audit is therefore disallowing $94, 039 in adjustments that were noted during the audit period and seeking reimbursement for this amount.

We believe that the evidence obtained during the audit provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

| Glenn C Fernandes | M.V. Songtantaruk | Dandan Wang |
|---|---|---|
| Glenn Fernandes, CPA<br>Director, Internal Audit | Margaret Songtantaruk, CFE, CB<br>Senior Auditor | Dandan Wang, CPA, CIA<br>Senior Auditor |

| RESPONSIBLE MANAGEMENT TEAM |
|---|
| Jim Schone, Director AV Business Development |
| James Jennings, Manager Aviation Properties |
| Jason Johnson, Aviation Property Manager 3 |
| Linda Nelson, Manager, AV Finance & Budget |
| Rudy Caluza, Director Accounting & Financial Reporting |
| |

## BACKGROUND

Avis Budget, headquartered in Parsippany, N.J., provides vehicle and car sharing services, operating four brands in the industry through Avis, Budget, Payless, and Zipcar. It possesses a local administrative office to oversee these brands' operations, and a fleet of vehicles at the Consolidated Rental Car Facility owned by the Port of Seattle (Port), and located at the Seattle-Tacoma International Airport. The rental car concession agreement with Avis Budget became effective in May of 2012.

The terms of the agreement require a Minimum Annual Guarantee (MAG) of 85% of the total amount paid to the Port in the previous agreement year or the MAG for the first agreement year at $5,950,000.00, whichever is greater. In addition, the agreement requires a Percentage Fee equal to 10% of gross revenues, provided the Percentage Fee is higher than the MAG payment.

The agreement allows the following exclusions from gross revenues:

- Any federal, state, county or city sales tax or other similar taxes or surcharges that are levied on rental cars or other ancillary business transactions, separately stated to and collected from the customer of The Operator and paid in full by the Operator to the taxing authority.
- Any amounts received as insurance proceeds or otherwise for damage to vehicles or other property of the Operator, or for loss, conversion or abandonment of such vehicles.
- Revenue from the wholesale transfer of salvage vehicles.
- All non-revenue rentals to employees of Operator.
- The Customer Facility Charge (CFC).

## FINANCIAL HIGHLIGHTS

| REPORTED GROSS REVENUE AND CONCESSION CALCULATION | | | CUSTOMER FACILITY CHARGE |
|---|---|---|---|
| **Agreement Year** | **Reported Gross Revenues** | **Paid Concession** | **Reported CFC** |
| 2013 - 2014 | $66,588,044 | $6,658,804 | $8,001,924 |
| 2014 - 2015 | 69,606,505 | 6,960,651 | 8,159,694 |
| 2015 - 2016 | 75,439,321 | 7,543,932 | 8,678,544 |
| **Total** | **$211,633,870** | **$21,163,387** | **$24,840,162** |

**Data Source: PROPWorks and PeopleSoft Financial.**

## AUDIT SCOPE AND METHODOLOGY

We conducted this performance audit 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 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.

We utilized a risk-based approach from the planning phase to the testing phase of our audit. We gathered information through document requests, research, interviews, observations, and analytical reviews. We also obtained a complete understanding of the Avis Budget car rental concession agreement. We applied the following audit procedures to assess whether Avis Budget was complying with the key terms of the agreement:

1. Reviewed the agreement, and identified key agreement provisions.

2. Gained an understanding of and documented Port management internal controls over insurance, surety, and AFR billing processes.

3. Tested effectiveness of the internal controls to verify:
    - Monthly concession was reviewed for accuracy prior to billing.
    - Annual concession reconciliation was performed to ensure accuracy of the reported gross revenues.
    - Surety and Insurance were in compliance with the agreement.

4. Analyzed the Port billing and payment records to determine timeliness of the MAGs, Percentage Fees, and CFCs.

5. To determine whether the CFCs were collected properly, and remitted to the Port, we:
    - Verified Avis and Budget at the facility were the only two locations at the airport that were subject to the CFC.
    - Calculated 100% of the CFCs independently.
    - Compared the independent calculations with those reported to the Port.
    - Tested the vehicle rental agreements to verify completeness and accuracy.

6. To determine whether the gross revenues were complete and accurate, we:
    - Reviewed the concessionaire’s Chart of Accounts to determine whether all applicable revenue accounts were included in the gross revenues reported to the Port.
    - Conducted three-way reconciliations by month, with the concessionaire’s system rental revenue reports, general ledgers, and revenue reported to the Port.
    - Agreed the concessionaire’s system rental revenue reports to the Avis Budget CPA Independent certified gross revenues.
    - Tested the vehicle rental agreements to validate legitimacy and accuracy.

## SCHEDULE OF FINDINGS AND RECOMMENDATIONS

**1) RATING: HIGH**

**NON-COMPLIANCE WITH THE RECORD RETENTION REQUIREMENT RELATED TO KEY ACCOUNTING RECORDS - <u>REPEAT FINDING</u>**

This issue would normally be a "Medium Risk" issue, but since it is a repeat finding that has not been resolved, we are elevating the risk rating to high.

Section 8.1 of the agreement states, in part:

> "Operator shall maintain its records relating to the operation permitted by this Lease Agreement for a period of at least three (3) years after the end of each Agreement Year (or until the close of any ongoing audit thereof being conducted by, or on behalf of, the Port…" )

The agreement also requires that sufficient detail be maintained:

> "…. and otherwise reasonably satisfactory to the Port for the determination of any Customer Facility Charges or other computations, or both, which may be necessary or essential in carrying out the terms of this Lease Agreement."

Avis Budget was unable to provide supporting documentation to verify whether the customer adjustments were legitimate and valid. These adjustments reduced gross revenue and the concession fee paid to the Port. As of November 28, 2017 Avis has indicated that they do not maintain this documentation. Therefore, these adjustments are not allowed.

The following table demonstrates the financial impact of the unsupported adjustments:

| Agreement Year | Customer Adjustments | Percentage of Revenue | Total Due to Port |
|---|---|---|---|
| 2013 - 2014 | $584,979 | 10% | $58,498 |
| 2014 - 2015 | 470,126 | 10% | 47,013 |
| 2015 - 2016 | 470,262 | 10% | 47,026 |
| | | **Total** | **$152,537** |

**Recommendations:**

We recommend that management:

- Discuss retention of adjustment detail with Avis Budget and determine whether going forward, they are able to maintain detail on said adjustments. Document the communication for future reference.
- Seek and recover the concession fee for the two years ended May 2015 and May 2016 during which period, Avis Budget was required to maintain records relating to the operation permitted by the lease agreement. This amounts to $94,039 due to the Port. The agreement year ended May 2014 was more than three years from the commencement of the audit, therefore, the amount of $58,498 cannot be pursued.

- Assess the applicability of the one-time late charge and any accrued interest caused by the underpaid concessions. Seek recovery if appropriate.

**Management Response/Action Plan:**

Aviation Commercial Management will pursue collection of concession fees from Avis Budget for the adjustments, for which they were not able to provide supporting documentation, and the applicable late fees and interest. Aviation Commercial Management will also clarify with Avis Budget the records we expect them to retain in accordance with Article 8 of the Lease. The results of these discussions will be documented in a letter from the Port to Avis Budget.

## APPENDIX A: RISK RATINGS

Findings identified during the course of the audit are assigned a risk rating, as outlined in the table below. The risk rating is based on the financial, operational, compliance or reputational impact the issue identified has on the Port. Items deemed "Low Risk" will be considered "Exit Items" and will not be brought to the final report.

| Rating | Financial | Internal Controls | Compliance | Public | Port Commission/ Management |
|---|---|---|---|---|---|
| **HIGH** | Large financial impact<br><br>Remiss in responsibilities of being a custodian of public trust | Missing, or inadequate key internal controls | Noncompliance with applicable Federal, State, and Local Laws, or Port Policies | High probability for external audit issues and/or negative public perception | Important<br><br>Requires immediate attention |
| **MEDIUM** | Moderate financial impact | Partial controls<br><br>Not adequate to identify noncompliance or misappropriation timely | Inconsistent compliance with Federal, State, and Local Laws, or Port Policies | Potential for external audit issues and/or negative public perception | Relatively important<br><br>May or may not require immediate attention |
| **LOW/ Exit Items** | Low financial impact | Internal controls in place but not consistently efficient or effective<br><br>Implementing/enhancing controls could prevent future problems | Generally complies with Federal, State and Local Laws or Port Policies, but some minor discrepancies exist | Low probability for external audit issues and/or negative public perception | Lower significance<br><br>May not require immediate attention |
| **Efficiency Opportunity** | An efficiency opportunity is where controls are functioning as intended; however, a modification would make the process more efficient | | | | |