



JACKSON COUNTY
Oregon

Internal Audit Report

**Changes in Rental Car Agreement Terms Would Facilitate
Airport Administration of the Agreement**

June 2011

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**JACKSON
COUNTY**
Oregon

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To: Board of Commissioners
From: Debbie Taylor, County Auditor
Subject: Airport Rental Car Concessionaire Agreement Audit
Date: June 13, 2011

This report presents the results of an internal audit over the Airport's administration of their rental car concessionaire agreements. The objectives of this audit were to determine if the Airport has properly designed and implemented internal controls that reasonably ensure that the concessionaires comply with the five-year agreement and determine if the concessionaires' gross receipts and customer facility charges, as reported to the Airport, were computed in accordance with procedures established by the Airport. The audit was included in the fiscal year 2009-10 and 2010-11 Annual Internal Audit Plans.

The report findings were reviewed with the Audit Committee, as well as Bern Case, the Airport Director and Marcy Black, the Airport Deputy Director of Administration.

The Internal Audit Program appreciates the cooperation and assistance received from the Airport throughout the course of the audit.

C: Audit Committee
Kenneth Kuhns, & Co. Certified Public Accountants

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Changes in Rental Car Agreement Terms Would Facilitate Airport Administration of the Agreement

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Executive Summary

The Rogue Valley International – Medford Airport (Airport) entered into five-year agreements, effective July 1, 2006 and expiring August 30, 2011 (agreement), with five rental car companies (concessionaires). The agreement allows the concessionaires to operate at the Airport in exchange for: counter and office space, parking spaces, service storage area, and the greater of a minimum annual guarantee (MAG) or percentage fee equal to ten percent (10%) of annual gross receipts.

In addition to the greater of the MAG or percentage fee revenue paid to the Airport, Jackson County (County) Ordinance established a customer facility charges (CFC) fee upon each rental car concessionaire, which became effective in July 2006. The fee was set at \$3.00 per transaction day and has not been adjusted; however, the fee can be periodically adjusted to reflect the actual cost the County incurs from concessionaires' customer use.

Internal controls over Airport administration of concessionaire agreements could be enhanced in the following areas:

1. Clarification of language in the Airport's agreement with the concessionaires could be enhanced;
2. Dissemination of concessionaire communication with other concessionaires could be enhanced; and
3. Clarification of unearned revenue recognition, due to financial reporting timing issues, could be obtained from County Financial Department and external auditor.

Gross receipts and customer facility charges (CFC) were not consistently computed in accordance with Airport procedures. By including the percentage fee in gross receipts, certain concessionaires charged their customers approximately 11% to recoup the percentage fee. Current concessionaire customer facility charges (CFC) business practices do not appear to follow County Ordinance.

We reviewed a draft of this report with Airport management, who generally agreed with our findings and recommendations.

To help improve concessionaire agreements and Airport's administration of those agreements, we recommend Airport management:

1. Clarify the definition of gross receipts in the agreement with the concessionaires to either include or exclude the percentage fee, and include an understanding that the percentage fee can be recouped from the concessionaires' customers. In addition, specify the maximum percentage of gross receipts that can be recouped from the customer;
2. Develop a standardized concessionaire monthly reporting form that provides sufficient detail to determine if gross receipts and other necessary items are correctly reported and include the form as an appendix to the agreement with the concessionaires;
3. Ensure that all communication between the Airport and concessionaires, whether a question, request for an item to be excluded from gross receipts or other agreement discussions, are distributed to all concessionaires. If applicable, consider amending the agreement based on the results of the disseminated communication;
4. Consider modifying the County Ordinance for customer facility charges (CFC) to correspond with current concessionaire business practices; and
5. Discuss unearned revenue recognition with County Finance Department and external auditor, to clarify treatment for County financial reporting.

Chapter 1 **Audit Authority, Objectives, Scope and Methodology**

Audit Authority The audit was conducted in accordance with Codified Ordinance 218 pertaining to the County Auditor. The Rogue Valley International – Medford Airport (Airport) management requested the audit due to variances they noted during their monitoring procedures over rental car concessionaires’ customer facility charges (CFC). The concessionaire agreement grants the County the right to authorize an audit of the concessionaires in relation to the agreement terms.

Change in Audit Objective The initial objective of the audit was to review CFC collected by the rental car concessionaires and then remitted to the Airport; however, the objective was expanded to include a review of the concessionaires’ gross receipts, as reported to the Airport and the remittance of concessionaires’ minimum annual guarantee (MAG) and percentage fee revenue to the Airport. The Airport collects information provided by the concessionaires and monitors that information. Based on the Airport’s collected information, one concessionaire earned significantly more than the other concessionaires; however, they remitted approximately 2% less in CFC than the other concessionaires. The variable shared by gross receipts and CFC is rental days. During our review, we found two contributing factors as to why one concessionaire reported more gross receipts and remitted less CFC. These factors were discussed with the Airport. One factor is included in the report; the other factor was not significant and therefore was not included in the report.

Audit Objectives The objectives of the audit were to:

1. Determine if the Airport has properly designed and implemented internal controls that reasonably ensure that the concessionaires comply with the five-year agreement; and
2. Determine if the concessionaires’ gross receipts and customer facility charges, as reported to the Airport, were computed in accordance with procedures established by the Airport.

Audit Scope & Methodology

We reviewed each of the five rental car concessionaires' monthly revenue reports and customer rental agreement data¹, and Airport financial and performance data for the months of September 2006, December 2007, March 2008, June 2009, March 2010 and others as deemed necessary. In addition, the concessionaires' websites were reviewed, specifically related to renting a car at the Airport.

Internal Controls

We gained an understanding of internal control processes by discussing the Airport's procedures with the Airport Deputy Director of Administration and other Airport staff. In addition we reviewed Codified Ordinance of Jackson County Chapter 1062, Section 1062.72 Customer Facility Charge and Car Concession Agreements, effective July 1, 2006.

Criteria

Criteria represent the laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation.

Criteria for our audit consisted of, but were not limited to:

- County Ordinance Part Ten, Title Six, Chapter 1062, Section 1062.72 – Customer Facility Charge; and
- Car Concession Agreements, effective July 1, 2006

Privileged and Confidential Information

We omitted detailed information about the concessionaires, including rental car company names; this information was provided to Airport management.

Compliance with Government Auditing Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our audit 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.

¹ Due to a merger, a concessionaire was unable to provide data for all requested months; however, we received additional evidence in order to support our conclusions.

Chapter 2 Introduction and Background

Five rental car companies operate at the Medford Airport and are required to pay a minimum annual guarantee

The Rogue Valley International – Medford Airport (Airport) entered into five-year agreements, effective July 1, 2006 and expiring August 30, 2011 (agreement), with five rental car companies (concessionaires). The agreement allows the concessionaires to operate at the Airport in exchange for: counter and office space, parking spaces, service storage area, and the greater of a minimum annual guarantee (MAG) or percentage fee equal to ten percent (10%) of annual gross receipts. Gross receipts are defined as the total amount charged by the concessionaire during an agreement year, including any separately stated fees and charges, in connection with: 1) concessionaires’ rental car business; 2) any activities related directly or indirectly to that business; and 3) any other business of concessionaire in the operating areas, in concessionaires’ designated service facility, or elsewhere at the Airport. Gross receipts include, but are not limited to, time and mileage, fueling, and charges for personal accident insurance and other insurance. Table 1 below shows gross receipts reported by the concessionaires to the Airport by agreement year².

TABLE 1 – Gross Receipts Reported by Concessionaire

Rental Car Company	2006-07 Gross Receipts	2007-08 Gross Receipts	2008-09 Gross Receipts	2009-10 Gross Receipts
#1	\$2,038,422	\$2,033,560	\$1,845,315	\$2,069,206
#2	\$1,683,667	\$1,623,888	\$1,351,659	\$1,403,248
#3	\$1,204,317	\$1,263,954	\$1,246,916	\$1,250,783
#4	\$838,959	\$856,604	\$755,040	\$1,016,869
#5	\$1,841,148	\$1,689,052	\$1,463,380	\$1,481,833
Total	\$7,606,513	\$7,467,058	\$6,662,310	\$7,221,939

The MAG and percentage fee revenue varies by agreement year and concessionaire. Table 2 below presents the MAG and actual percentage fee revenue by agreement year, of which the concessionaires’ were required to remit the greater of to the Airport.

TABLE 2 – Concessionaires’ MAG and Percentage Fee

Rental Car Company	2006-07		2007-08		2008-09		2009-10	
	MAG	% Fee	MAG	% Fee	MAG	% Fee	MAG	% Fee
#1	\$201,000	\$203,842	\$212,000	\$203,356	\$180,944	\$184,532	\$233,000	\$206,921
#2	\$180,000	\$168,367	\$202,000	\$162,389	\$165,908	\$135,166	\$232,000	\$140,325
#3	\$132,000	\$120,432	\$144,000	\$126,395	\$120,338	\$124,692	\$155,000	\$125,078
#4	\$130,000	\$83,896	\$145,000	\$85,660	\$106,160	\$75,504	\$160,000	\$101,687
#5	\$163,448	\$184,115	\$168,351	\$168,905	\$144,533	\$146,338	\$178,604	\$148,183

² September 1 through August 30

One-twelfth of the MAG is paid in monthly installments in advance on the first day of each month. Ten percent (10%) of monthly gross receipts that exceed one-twelfth of the MAG³ is paid twenty days after the end of each calendar month. The amount paid to the Airport is reconciled annually after year end, with the concessionaires' total MAG required to be paid. If the concessionaire paid more than the greater of the required MAG or percentage fee the Airport reimburses the difference to the concessionaire.

A customer facility charge is applied to each transaction day

In addition to the greater of the MAG or percentage fee paid to the Airport, Jackson County (County) Ordinance established a customer facility charges (CFC) fee upon each rental car concessionaire, which became effective in July 2006. The fee was set at \$3.00 per transaction day and has not been adjusted; however, the fee can be periodically adjusted to reflect the actual cost the County incurs from concessionaires' customer use. The CFC is to be collected on a daily basis for all cars rented for twenty-four or fewer hours for the first transaction day, and every twenty-four hours for each transaction day thereafter. The agreement requires the five concessionaires' to collect and remit the CFC within twenty days after the end of each calendar month.

The variable shared by gross receipts and CFC is rental days. Table 3 below shows the CFC fees remitted by the concessionaires to the Airport by agreement year.

TABLE 3 – CFC Fees Remitted by Concessionaire to Airport

Rental Car Company	2006-07 CFC Fees	2007-08 CFC Fees	2008-09 CFC Fees	2009-10 CFC Fees
#1	\$96,816	\$84,534	\$76,482	\$83,250
#2	\$104,502	\$101,289	\$76,467	\$72,024
#3	\$78,615	\$80,127	\$84,513	\$70,410
#4	\$62,688	\$65,430	\$55,926	\$65,472
#5	\$131,007	\$122,505	\$103,230	\$109,491
Total	\$473,628	\$453,885	\$396,618	\$400,647

³ Percentage Fee

Chapter 3 Internal Controls over Airport Administration of Concessionaire Revenue Could be Enhanced

Internal control, sometimes referred to as management control, includes the plan, policies, methods, and procedures adopted by management to meet its missions, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.

Agreement language

Language in the Airport’s agreement with the concessionaires could be enhanced to clarify expectations for the concessionaires reporting to the Airport.

Itemization of monthly concessionaire reports and Airport’s definition for gross receipts could use clarification

An agreement between two parties is used to reduce the risk of liability and alleviate confusion over agreed upon terms. The five-year concessionaire agreement, effective July 1, 2006 (agreement) required the itemization of gross receipts to be included on the monthly revenue statement provided to the Airport.

The monthly revenue reports provided by each concessionaire to the Airport, and even sometimes the concessionaires’ month-to-month reports, differed. For example, as further discussed in chapter four, the percentage fee should not have been included in gross receipts. By including the percentage fee in gross receipts, certain concessionaires charged their customers approximately 11% to recoup the 10% percentage fee. The lack of itemization of gross receipts and clear break-out of the customer facility charges (CFC), percentage fee, monthly minimum annual guarantee (MAG), and other necessary items inhibits the Airport’s ability to review compliance with the concessionaire agreement.

**Advance
Percentage Fee
Payments**

Due to financial reporting timing issues, advance percentage fee payments were not recorded as unearned revenue, causing immaterial misstatements of revenue and ending fund balance in the County's financial records.

The Airport's operations are accounted for in the Airport Enterprise Fund. In accordance with generally accepted accounting principles, Enterprise Fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned, regardless of when the related cash flows take place.

Each year in May, the County's Finance Department sends a memorandum to departments reminding them of procedures that need to be followed in conjunction with closing the County's financial books for the fiscal year. The memorandum includes the following instructions:

Unearned Revenue: *If you have received any revenues dedicated for a specific purpose (such as a grant) and the County has not yet performed this purpose, this is considered to be "unearned revenue". The unearned revenue schedule is due in Accounting by July 12.*

The concessionaires are required to remit a monthly revenue report twenty days after the end of each calendar month. With this report, the concessionaires remit advanced percentage fee payments when 10% of their monthly gross receipts exceed their monthly minimum annual guarantee (MAG). The agreement requires the concessionaire to remit the greater of the MAG or percentage fee⁴ at the end of each agreement year, which extends September 1 through August 30. The amount paid to the Airport is reconciled annually after August. If the concessionaire paid more than the greater of the required MAG or percentage fee the Airport reimburses the difference to the concessionaire. The agreement year does not coincide with the County's fiscal year⁵, which inhibits the recording of unearned revenue for financial reporting purposes.

⁴ The percentage fee is equal to 10% of gross receipts.

⁵ July 1 through June 30

The MAG usually has been greater than the percentage fee at the end of the agreement year, largely due to the economic downturn, and this has required the Airport to refund the advanced percentage fee at the end of each agreement year. Table 4 provides an example of how the agreement, for the most part, is being administered.

TABLE 4 – Example of Concessionaire and Airport Payment Process

Description of Payment Process	Amount
Yearly Minimum Annual Guarantee	\$144,000
Total Advanced Percentage Fee	\$20,000
Total Amount Paid to Airport	<u>\$164,000</u>
Actual 10% of Gross Receipts (Percentage Fee)	\$130,000
Total Refund Amount	\$20,000

In the example presented above, the advance payments represented unearned revenue, which was a liability and technically the Airport should not have used the cash advance to pay for current operations. Table 5 shows the approximate amount of unearned revenue by County fiscal year.

TABLE 5 – Unearned Revenue At Year-End

Fiscal Year	Unearned Revenue⁶
2006-07	\$15,949
2007-08	\$9,664
2008-09	\$7,580
2009-10	\$6,347
Total	\$39,540

⁶ The five-year agreement lists certain conditions where the minimum annual guarantee will be abated for the period of time the condition continues to exist. For the 2008-09 agreement year, the Airport provided the concessionaires an abatement refund. The results of the abatement were not included in the calculation of unearned revenue. See Appendix A for the abatement agreement terms.

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Chapter 4 **Gross Receipts and Customer Facility Charges Were Not Consistently Computed in Accordance with Airport Procedures**

<i>Gross Receipts</i>	<i>Determination of gross receipts was not consistent between concessionaires.</i>
<p><i>Unallowed inclusion in gross receipts caused 11% to be charged to customers</i></p>	<p>The five-year agreement, effective July 1, 2006 (agreement), did not address if percentage fees should or should not be included in gross receipts. The agreement also did not address if there was an understanding that the concessionaires were able to recoup the 10% percentage fee, or an additional concession fee, from its customers. A review of the concessionaires' monthly revenue reports and customer rental agreement data, and Airport financial and performance data for the months of September 2006, December 2007, March 2008, June 2009, March 2010 and others as deemed necessary was conducted. In addition, the concessionaires' websites were reviewed, specifically in relation to renting a car at the Airport. The results of the review showed that four of the five concessionaires were including the percentage fees in their gross receipts and were charging customers approximately 11% to recoup the percentage fee.</p> <p>In a prior County concessionaire audit, it was agreed that the percentage fees should be included in gross receipts; however, this was prior to the current agreement. There was an established understanding between the concessionaires and the Airport that recouping the percentage fee from the customer was an allowable practice. Prior to entering into the current agreement, the Airport and the concessionaires held a pre-proposal meeting to discuss the agreement. The discussion included that the percentage fee should not be included in gross receipts and the concessionaires could not charge the customer more than 10% to recoup the percentage fee.</p> <p>In 2006 and 2008, one concessionaire inquired of the Airport to clarify that the percentage fee should not be included in gross receipts and charging more than 10% to the customer was not allowed. The concessionaire also noted that the other concessionaires were charging customers 11% to recoup the percentage fee. Table 6 provides an example of how the 11% was derived.</p>

TABLE 6 – Example of 11% Derivation

Inclusions in Gross Receipts	Amount
Customer Time & Mileage Revenue	\$160,000
Percentage Fee Recoupment (1)	\$20,000
Other	\$20,000
Total Gross Receipts	\$200,000
10% of Gross Receipts, as reported to the Airport	\$20,000
Gross Receipts without Percentage Fee Recoupment (2)	\$180,000
Actual Percentage Fee [(1)/(2)]	11%

In 2009, the Airport provided the inquiring concessionaire with a letter clarifying that their understanding was correct. The Airport stated that they had not audited the other concessionaires so could not confirm if they were charging 11%. However, the Airport did not communicate this clarification to all concessionaires operating at the Airport, because these questions were addressed during the pre-proposal meeting.

By including the percentage fee in gross receipts, certain concessionaires charged their customers approximately 11% to recoup the percentage fee. Table 7 below shows the approximate amount potentially overcharged to the concessionaires' customers.

TABLE 7 – Overcharge to Customers by Airport Concessionaires

Rental Car Company	Amount Overcharged to Customers (September 2006-August 2010)
#1	\$79,000
#2	\$60,000
#3	\$49,000
#4	\$0
#5 ⁷	\$42,000
Total	\$230,000

Due to the current economic downturn, the minimum annual guarantee (MAG) usually has been greater than the percentage fee at the end of the agreement year, thus the customer overcharge does not directly provide the Airport with an additional benefit. This conclusion was further discussed in chapter three.

⁷ On August 1, 2007 this concessionaire was purchased by another concessionaire. The reporting of gross receipts by this concessionaire was changed around the time they were acquired.

<i>Customer Facility Charges</i>	<i>Current concessionaire customer facility charges (CFC) business practices do not appear to follow County Ordinance.</i>
<i>Current concessionaire business practices do not appear to follow County Ordinance</i>	Based on review of the concessionaires' data, it appears that if a customer returns a vehicle late the concessionaire is recording an extra rental day for that customer. The \$3.00 customer facility charges (CFC) rate is applied to how many rental days occurred per month. The County Ordinance specifies that a \$3.00 CFC be charged for the first day for a twenty-four or less hour period and for every twenty-four hour period after that. The tardiness does not equate to a twenty-four hour period; however, the concessionaires were charging an additional \$3.00 for this tardiness. Per the concessionaires' websites, inquiry of certain concessionaires, and review of the concessionaires' data, this practice is consistent between concessionaires.

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Chapter 5 **Audit Recommendations and Management Response**

Audit Recommendations

To help improve concessionaire agreements and Airport's administration of those agreements, we recommend Airport management:

1. Clarify the definition of gross receipts in the agreement with the concessionaires to either include or exclude the percentage fee, and include an understanding that the percentage fee can be recouped from the concessionaires' customers. In addition, specify the maximum percentage of gross receipts that can be recouped from the customer;
2. Develop a standardized concessionaire monthly reporting form that provides sufficient detail to determine if gross receipts and other necessary items are correctly reported and include the form as an appendix to the agreement with the concessionaires;
3. Ensure that all communication between the Airport and concessionaires, whether a question, request for an item to be excluded from gross receipts or other agreement discussions, are distributed to all concessionaires. If applicable, consider amending the agreement based on the results of the disseminated communication;
4. Consider modifying the County Ordinance for customer facility charges (CFC) to correspond with current concessionaire business practices; and
5. Discuss unearned revenue recognition with County Finance Department and external auditor, to clarify treatment for County financial reporting.

Management Response

Airport management agrees with the audit recommendations and will modify language and reporting requirements in new Car Rental Concessionaire agreements to be solicited this year and implement other processes to enhance their administration

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Appendix A Abatement Agreement Terms

The Rogue Valley International – Medford Airport (Airport) entered into five-year agreements, effective July 1, 2006 and expiring August 30, 2011 (agreement), with five rental car companies (concessionaires).

The agreement grants concessionaire's abatement rights as follows:

"In the event that one of the following conditions exists during the term hereof, the minimum annual guarantee as provided for in section 6.1 shall be abated for the period of time the condition continues to exist:

- a) If for any reason, the number of passengers deplaning on scheduled airline flights at the Airport during any period of ninety (90) consecutive days, shall be less than eight-five percent (85%) of such deplaning passengers in the same period during the preceding calendar year or in the year immediately preceding the first full year of this agreement. The Airport will provide monthly enplanement and deplaning figures to concessionaire.*
- b) During the period of abatement provided in subparagraphs (a) and (b) of this Section, concessionaire will continue to pay the County a fee in the amount of 10 percent (10%) of the concessionaire's gross receipts during that period and the County will return to concessionaire a just proportion of any minimum annual guarantee payment which may have been prepaid.*
- c) In the event the premises are damaged rendering them uninhabitable or destroyed due to fire or other casualty, the minimum guarantee shall be abated until the premises have been repaired and made operational or office and counter has been relocated."*