



INTERNAL AUDIT REPORT

RENTAL CAR CONCESSION AGREEMENT AUDIT

The Hertz Corporation dba Hertz Car Rental

JUNE 1, 2014 – MAY 31, 2016

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	2
BACKGROUND	3
FINANCIAL HIGHLIGHTS	3
AUDIT SCOPE AND METHODOLOGY.....	3
SCHEDULE OF FINDINGS AND RECOMMENDATIONS	6
1. NONCOMPLIANCE WITH THE AGREEMENT REQUIREMENT	6
APPENDIX A: RISK RATINGS.....	9

EXECUTIVE SUMMARY

Internal Audit (IA) completed a rental car concession audit of Hertz Corporation, dba Hertz Car Rental (Hertz) for the period June 1, 2014 – May 31, 2016. The audit was performed to determine whether Port management’s monitoring controls were effective and to assure that: Hertz reported Concession Fees were complete, properly calculated, and remitted timely to the Port; that Hertz 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 Hertz materially complied with the terms of car rental agreement, and that management controls were effective to assure the reported concession fees were complete, properly calculated, and remitted timely to the Port. We noted two exceptions with the CFC:

- Hertz did not collect the CFC at their three local locations within a three-mile radius of the airport. The CA specifically requires Hertz to collect and remit the CFC to the Port for these locations if the customer arrives by plane within 12 hours. Our audit showed that in most cases a CFC was due to the Port, amounting to \$205,236 during our audit period.
- Additionally, Hertz did not consistently comply with their vehicle drop-off policy at the Consolidated Rental Car Facility location, resulting in approximately \$9,210 in CFCs due to the Port

These two items resulted in an underpayment to the Port in the amount of \$214,446 during the two year audit period. These issues are discussed in more detail beginning on page six of this report.

Section 8.2.1 of the Lease Agreement requires “the full cost of the audit be borne by the lessee in the event an audit reveals a discrepancy of more than 1% of the CFC for any 12-month period.” The discrepancy was greater than 1% for each of the two years in the audit period, thereby requiring Hertz to absorb the cost of this audit.

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.



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BACKGROUND

The Hertz Corporation (Hertz), a subsidiary of Hertz Global Holdings, Inc., is headquartered in Estero, Florida. Hertz provides rental cars, trucks, and equipment, operating through Dollar Rent A Car, Inc., Hertz Car Rental, Donlen Corporation, and Flexicar. The Hertz Corporation maintains a local administrative office and fleet maintenance at the Consolidated Car Rental Facility owned by the Port of Seattle (Port). Hertz operates three local locations within a 3-mile radius (Marriott Hotel, Doubletree Hotel, and Burien) of the Seattle-Tacoma International Airport boundary in addition to the Consolidated Rental Car Facility and ASIG facility (which services corporate/general aviation needs) under audit period.

The terms of the agreement provide for a Minimum Annual Guarantee (MAG) of 85% of the total amount paid to the Port in the previous agreement year. Additionally, the agreement requires a Percentage Fee equal to 10% of gross revenues, provided the Percentage Fee is higher than the monthly MAG payment.

FINANCIAL HIGHLIGHTS

REPORTED GROSS REVENUE AND CONCESSION CALCULATION			CUSTOMER FACILITY CHARGE
AGREEMENT YEAR	REPORTED GROSS REVENUES	CONCESSION FEES	REPORTED CFC FEES
2014 - 2015	\$54,963,037	\$5,496,304	\$5,379,168
2015 - 2016	55,923,031	5,592,303	5,535,618
TOTAL	\$110,886,068	\$11,088,607	\$10,914,786

Data Source: PeopleSoft Financials and Propworks

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 Hertz CA. We applied the following audit procedures to assess whether Hertz complied with the key terms of the agreement:

1. To determine whether Port management monitoring controls were effective to assure compliance with the significant terms of the agreement, we:
 - a. Read the Concession Agreement between the Port and Hertz, focusing on sections: 4 revenue; 6.2.1 Airport Customer; 9.1.1.4 CFC; 17 Indemnity & Insurance; and 9 Bond or Other Security.
 - b. Gained an understanding of and documented Port management controls over insurance, surety, and AFR billing processes.
 - c. Tested the effectiveness of internal controls to verify that:
 - o Monthly concessions were reviewed for accuracy prior to billing.
 - o Annual concession reconciliations were performed to validate completeness of reported gross revenue.
2. To determine whether reported gross revenues were complete and reasonable, we:
 - a. Reviewed the lessee's chart of accounts to determine whether all revenue accounts were included in the determination of gross concession revenue reported to the Port.
 - b. Obtained monthly concession reports for all months in the engagement period from Accounting & Financial Reporting (AFR).
 - c. Obtained Business Daily Reports (BDR) from Hertz for all revenue sources and rental car facility charges for all months in the engagement period. Revenue reports included separate revenue listings for local and non-local customers, as well as miscellaneous income accounts.
 - d. Compared total amounts from revenue reports obtained in step c to corresponding amounts in the monthly concession reports obtained in step b.
 - e. Reconciled the BDR to Hertz's independent certified audited statement of gross revenues report, and to the AFR year-end true up.
 - f. Selected 84 rental agreements deemed high-risk for the audit period, and determined whether the revenue on the face of each rental agreement agreed to the amount recorded on the BDR, and assured that commercial discounts did not reduce concession revenue.
3. To determine whether the Customer Facility Charge (CFC) was properly collected and remitted to the Port, we:
 - a. Analyzed and evaluated the Lessee's methodology of the CFC calculation.
 - b. Tested a risk-based sample of 104 opened & closed car rental agreements to determine whether the CFC calculation was accurate.
 - c. Recalculated 100% of the CFC populations based on the Lessee provided BDR records, of all rental agreements for the audit period.
4. To determine whether MAG/Concession Fee payments were remitted timely, we:
 - a. Identified payment due dates.
 - b. Analyzed Port records to determine whether payments were received in a timely manner.
5. To determine whether the Letter of Credit or other Security deposit were maintained as required, we:
 - a. Identified the Letter of Credit in the agreement.
 - b. Tested three years of rent security amounts as required.

6. To determine whether the insurance requirement was maintained, we:
 - a. Verified that insurance certificates, as required in the agreement, were provided to the Port during the audit period.
 - b. Verified and tested two years insurance coverages as required.

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Risk: Medium

1. NONCOMPLIANCE WITH THE AGREEMENT REQUIREMENT

Hertz operates car rental facilities at the following three locations, within a three-mile radius of the SeaTac Airport boundary, which Hertz refers to as location 7340:

- SeaTac Marriot
- Doubletree
- Burien Chevrolet

We determined that Hertz was not collecting the CFC at the above three locations during the period audited because Hertz used the wrong criteria to exclude both local rentals and CFCs, and this resulted in CFCs that were not remitted to the Port in the amount of \$205,236.

Section 9.1.14 of the Concession Agreement (“CA”) states:

“At all locations within three miles of the Airport, the Concessionaire’s motor vehicle rental agreements shall be printed or stamped in such form so as to provide a separate space for its customers to indicate by their signature if they are *not* an “Airport Customer” as defined in Attachment 1. Any rental agreement which does not have a customer signature upon it designating that the customer is not an “Airport Customer” shall be treated hereunder as though such customer is an “Airport Customer” for purposes of computing compensation due to the Port under this Concession Agreement.”

Section 1.5, stipulates:

“Airport Customer” shall mean: “(i) any person who comes to the Airport by any means of transportation and enters into a motor vehicle rental agreement with Operator at Operator’s Rental Car Concession; (ii) any person who flies into the Airport and within twelve (12) hours thereafter enters into a motor vehicle rental agreement with Operator at any of Operator’s rental car operations located within a three (3) mile radius of the Airport’s boundary line.”

Our data analysis and our review of the Hertz’s BDR (“Business Daily Report”) and detail transaction testing on activity at the above three locations, showed the following:

- 85% of car rental agreement drop-offs were at the Port’s Consolidated Car Rental Facility. Indicating that customers most likely flew in via the airport and picked up a rental car at an alternate airport location, thereby using airport facilities, services and rental car buses.
- 25% of the population tested were noted as local customers but customer signatures were absent on the car rental agreements. Additionally, in seven instances the car rental agreements showed that the concession fee was collected from the customer, but the CFC was not collected (if one is collected, the other should be as well).
- Of customers classified as “local customers”, 84% had had home zip codes outside of the 3 mile radius of the SeaTac Airport boundary.
- Approximately 13% of the car rental agreements lacked the customer signatures and/or initial certification as to whether the customer arrived by plane or not within the

past 12 hours.

Additionally, section 1.5 of the CA that defines an “Airport Customer” within a three-mile radius was not specific enough and thereby unclear.

Section 6.2 states:

“Operator shall collect a daily Customer Facility Charge on all vehicle rental transactions with Airport Customers... Each Operator must collect the Customer Facility Charge at the time of the first payment is made for a qualifying vehicle rental transaction, and must remit the full amount of the Customer Facility Charge to the Port regardless of whether or not the full amount of such Customer Facility Charge is actually collected by the Operator from the person who rented the Automobile.”

In addition, Hertz did not properly collect and remit CFCs of approximately \$9,210 from the Rental Car Facility location 1290, due to inconsistent application of their vehicle drop-off policy. (See below table for details)

UNDERREPORTED CUSTOMER FACILITY CHARGE (CFC) FOR HERTZ RENT-A-CAR					
AGREEMENT YEAR	AUDITED CFC FEES (ADJUSTED)			REPORTED CFC FEES	UNDER-REPORTED CFC FEES
	1290	7340	Total	1290 Only	
2014 - 2015	\$5,383,416	\$102,678	\$5,486,094	\$5,379,168	\$106,926
2015 - 2016	5,540,580	102,558	5,643,138	5,535,618	107,520
TOTAL	\$10,923,996	\$205,236	11,129,232	\$10,914,786	\$214,446
TOTAL DUE TO PORT					\$214,446

Data Source: The Hertz BDR records & PeopleSoft Financials

Additionally, Section 8.2.1 of the Lease Agreement requires “the full cost of the audit be borne by the lessee in the event an audit reveals a discrepancy of more than 1% of the CFC for any 12-month period.” As indicated below, the discrepancy was greater than 1% of each of the two years in the audit period as follows:

AGREEMENT YEAR	UNDERREPORTED CFC FEES	REPORTED CFC FEES	PERCENTAGE OF UNDERREPORTED CFC FEES
2014 - 2015	\$106,926	\$5,486,094	1.99%
2015 - 2016	107,520	5,643,138	1.94%

Recommendations

We recommend that Port Management:

1. Seek and recover \$214,446 (\$9,210 + \$205,236) for the underreported customer facility charge (CFC).
2. Seek and recover the audit cost of \$13,918, for work related to the CFC charge.
3. Assess the applicability of the one-time late charge and any accrued interest caused by the above underreporting. Seek recovery if appropriate.
4. Work with Hertz to assure that in the future, the CFC is collected and remitted for all locations within a three-mile radius, unless a valid exception exists.
5. Send a letter to Hertz to clarify and document the following:
 - a. Non-Local Customer - A customer with a home zip code outside the Airport boundary and/or from out-of-state.
 - b. The requirement that all customers place their initials next to the comments, certifying that they did not arrive by plane within the past 12 hours; Hertz will have the responsibility of validating related flight information.
 - c. A reminder that any vehicle rental agreement lacking a customer initial or signature is immediately reverted to an "Airport Customer" and the appropriate fees are charged.
 - d. A reminder that any cars dropped-off at the Consolidated Car Rental Facility and/or within the three-mile radius are charged the appropriate fees if not specifically exempted by items a. and b. above.

Management Response/Action Plan

Aviation Commercial Management will pursue collection from Hertz for the under-reported CFC's as stated above, the audit cost, and the applicable late fees and interest. Aviation Commercial Management will also work with Hertz to assure a mutual understanding of the definition of "Airport Customer" so that future interpretations are consistent for both the Port and Hertz. The results of these discussions will be documented in a letter from the Port to Hertz.

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 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 Requires immediate attention
MEDIUM	Moderate financial impact	Partial controls 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 May or may not require immediate attention
LOW/ Exit Items	Low financial impact	Internal controls in place but not consistently efficient or effective 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 May not require immediate attention