OFFICE OF THE CITY CONTROLLER

HOUSTON AIRPORT SYSTEMS
CONCESSIONS DIVISION

COMPLIANCE AUDIT OF CONCESSIONAIRE CONTRACT
NO. C52474 – AVIS RENT A CAR SYSTEM, INC.

Ronald C. Green, City Controller

David A. Schroeder, City Auditor

Report No. 2014-03
October 24, 2013

The Honorable Annise D. Parker, Mayor, City Council Members

SUBJECT: REPORT #2014-03

HOUSTON AIRPORT SYSTEMS (HAS), CONCESSION CONTRACT COMPLIANCE AUDIT
CONTRACT # C52474 – AVIS RENT A CAR SYSTEM, INC. (AVIS)

Dear Mayor Parker and City Council Members,

The Office of the City Controller has completed a Contract Compliance/Performance Audit of the Avis Rent a Car System, Inc. (Avis) Concession Agreement at George Bush Intercontinental Airport Houston (IAH) with the City of Houston (“COH” or “the City”) (Contract No. C52474 as originally passed on February 7, 2001 as Ordinance 2001-0137). Houston Airport System (“HAS”) monitors Avis for contract compliance. The term of this Agreement commenced on September 1, 2003 (Date of Beneficial Occupancy) and continues until the later of the 30th day of June 2027 or the final payment of bonds.

The original scope of this contract compliance review of the Agreement was originally the twelve month period ending August 2011. The scope of the CFC review was the 12 months ending August 2011. June 2011 rental activity and reporting was tested in detail. The primary objectives of this audit were to determine that Avis:

1. Accurately reported gross revenues to HAS in compliance with the Agreement;
2. Accurately computed and paid monthly concession fees to HAS in compliance with the Agreement;
3. Complied with the payment guarantee and annual certification requirements listed in the Agreement; and
4. Accurately reported and paid CFC payments to the trustee.

NOTE: We utilized the assistance of the professional services firm, Experis in performing substantive work.

As a result of the initial audit procedures performed, an element of gross revenues to be included in determining the concession fees owed to the City of Houston, a product called “Prepaid Fuel,” was not being reported resulting in an underpayment to the City, and thus, lost revenues. Professional standards require that an issue be put into context by measuring the impact and magnitude to the organization and/or process being audited, thus we expanded our scope to include the following additional procedures:

- Communicating with all Rental Car Companies under contract and the relevant HAS personnel to request information substantiating historical revenue reporting and concession payments to the City and obtain updated responses accordingly;
- Coordinating efforts with the City’s Legal Department to verify official position being represented on behalf of the City in negotiating/resolving differences of interpretation of terms in the event of enforcement, up to and including litigation;
- Compiling information received and validating consistency with previous revenue reporting; and
- Calculating the total underpayment to the City and the future impact of non-reporting of Prepaid Fuel

NOTE: These additional procedures impacted the timeline of the audit based on management responses taking the form, in part, of calculations and discussions of amounts owed and/or offer of settlement. To date of the report, the dialogue has not yielded satisfactory resolution. The results of procedures that identified proper reporting can be found in Table 1 of the report.
The most significant results of the audit procedures performed were:

- The total unreported gross revenues for Pre-Paid Fuel was $13,444,371, which results in an underpayment of concession fees to the Houston Airport System of between $1,592,642 and $1,641,694 for the period between 2003 and April 2012 (See table 2 and 3 in the report). Because the contract continues through 2027, this also results in an estimated future benefit of approximately $2,741,629 for a total of additional payments and savings of $4.4 Million to the City.
- As noted in Table 1 of the Report Hertz had unreported revenues for the period of FY2008 through FY2010. The unreported gross revenues were $5,906,681, yielding an additional concession payment due to the City of between $504,617 and $645,923.
- The total amount owed to the City is $2,287,617 and a total savings with future benefits of $5,028,246 from the two largest rental car groups.

We appreciate the time and efforts extended to the Audit Division during the course of the project and wish to acknowledge:

- Houston Airport System for their time and efforts in providing information and coordinating some of the communication.
- Legal Department for their expertise in contract interpretation and support in enforcing terms and conditions that protect the interests of the City stakeholders.

Respectfully submitted,

Ronald C. Green
City Controller

cc: Mario Diaz, Director, Houston Airport Systems
    Robert Bouta, Senior Vice President, Properties and Facilities, Avis/Budget
    City Council Members
    Chris Brown, Chief Deputy City Controller
    Waynette Chan, Chief of Staff, Mayor’s Office
    Andy Icken, Chief Development Officer, Mayor’s Office
    Kertecia Mond, Chief Auditor, Houston Airport Systems
    David Schroeder, City Auditor

Calculation: Additional Payment of $1,641,694 (2003-2012) * 1.5 (remaining 15 years of contract) = $2,741,629
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INTRODUCTION,
BACKGROUND AND
HIGHLIGHTS

The Office of the City Controller has completed a Contract Compliance/Performance Audit of the Avis Rent a Car System, Inc. (Avis) Concession Agreement at George Bush Intercontinental Airport Houston (IAH) with the City of Houston (“COH” or “the City”) (Contract No. C52474 as originally passed on February 7, 2001 as Ordinance 2001-0137. Houston Airport System (“HAS”) monitors Avis for contract compliance. The term of this Agreement commenced on September 1, 2003 (Date of Beneficial Occupancy) and continues until the later of the 30th day of June 2027 or the final payment of bonds.

The Agreement specifies compensation to the City for the rights granted by the City in this Agreement. The monthly concession fee is the greater of 1/12 of the Minimum Annual Guarantee or 10% of monthly Gross Revenues for the period September 2008 to August 2013. Gross Revenue is defined in the Agreement that lists revenues that are included or excluded in Gross Revenue. The Agreement also lists reporting requirements to HAS. In addition, the Master Special Facilities Lease Agreement specifies that Avis shall collect a Customer Facility Charge (“CFC”) from each customer. Avis is obligated to remit to the Trustee on behalf of the City all CFC proceeds actually collected.

For the 12 month period ending August 31, 2011 Avis reported Gross Revenues totaling $40,336,195 resulting in the concession fee due HAS totaling $4,033,620 (10% of Gross Revenues). For the 12 month period through August 31, 2011, Avis remitted $2,766,824 in CFC payments to the trustee.

AUDIT METHODOLOGY

The audit was performed in accordance with Generally Accepted Government Auditing Standards as promulgated by the Government Accountability Office (GAO) and the engagement was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing as issued by the Institute of Internal Auditors (IIA). Those standards require that we plan and perform the audit to obtain sufficient and 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.

AUDIT SCOPE AND OBJECTIVES

The scope of this contract compliance review of the Agreement was the twelve month period ending August 2011. The scope of the CFC review was the 12 months ending August 2011. June 2011 rental activity and reporting was tested in detail. The primary objectives of this audit were to determine that:

1. Avis accurately reported gross revenues to HAS in compliance with the Agreement;
2. Avis accurately computed and paid monthly concession fees to HAS in compliance with the Agreement;
3. Avis complied with the payment guarantee and annual certification requirements listed in the Agreement.
4. Avis accurately reported and paid CFC payments to the trustee.
The scope of our work did not constitute an evaluation of the overall internal control structure of the HAS contract management process. Management is responsible for establishing and maintaining a system of internal controls to ensure that financial activity is accurately reported and reliable. The objective is to provide management with reasonable, but not absolute assurance that the controls are in place and effective.¹

**PROCEDURES PERFORMED**

In order to obtain sufficient evidence to achieve engagement objectives and support our conclusions, we performed the following:

- Reviewed Gross Revenues for reasonableness based on deplaned passengers;
- Verified that Gross Revenues are reported and concession fees were calculated in compliance with the Agreement;
- Tested a sample of June 2011 rental agreements and related adjustments to recording in the Avis June 2011 monthly report;
- Selected a block of rental agreements to verify completeness of the June 2011 monthly report;
- Verified that the monthly Gross Revenues and concession fees summarized by HAS agree to the Avis monthly sales report and Avis check copies;
- Verified that annual audit of Gross Revenues and payment guarantee requirements were provided to HAS;
- Agreed CFC revenues summarized by HAS to copy of check and remittance letter from Avis; and
- Reconciled the CFC amount per June 2011 monthly report to payment amount from Avis for June 2011.

**AUDIT SCOPE MODIFICATION**

As a result of the initial audit procedures performed, an element of gross revenues to be included in determining the concession fees owed to the City of Houston, a product called “Prepaid Fuel”, was not being reported resulting in an underpayment to the City, and thus, lost revenues (NOTE: For results of testing associated with the original scope of June, 2011, was $74,930). Professional standards require that an issue be put into context by measuring the impact and magnitude to the organization and/or process being audited. Because the total gross revenues associated with rental car activity as reported for FY2011 was $251 Million, we expanded our scope to include all Rental Car Companies under contract with the City. This involved performing additional procedures which included:

- Communicating with all Rental Car Companies and the relevant HAS personnel to request information substantiating historical revenue reporting and concession payments to the City and obtain updated responses accordingly
- Coordinating efforts with the City’s Legal Department to verify official position being represented on behalf of the City in negotiating/resolving differences of interpretation of terms in the event of enforcement, up to and including litigation
- Compiling information received and validating consistency with previous revenue reporting
- Calculating the total underpayment to the City and the future impact of non-reporting of Prepaid Fuel

¹ This audit was not a financial audit; a financial audit provides reasonable assurance through an opinion (or disclaim an opinion) about whether an entity’s financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP), or with a comprehensive basis of accounting other than GAAP.
NOTE: These additional procedures impacted the timeline of the audit based on management responses taking the form, in part, of calculations and discussions of amounts owed and/or offers of settlement. Thus the result of this analysis is shown separately as a basis of context, not intended or designed as an audit of all rental car concession contracts. The monetary impact of Rental Car Companies besides Avis/Budget that did not report and/or pay based upon including Prepaid Fuel for any period of time are shown in this report for informational purposes. (See Table 1 and """" section of Conclusion for Objectives 1 and 2).

<table>
<thead>
<tr>
<th>Rental Car Company</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>AVIS</td>
<td>Not reported</td>
</tr>
<tr>
<td>BUDGET</td>
<td>Not reported</td>
</tr>
<tr>
<td>HERZ</td>
<td>Reported since 09/01/10</td>
</tr>
<tr>
<td>SIMPLY WHEELZ (Advantage)</td>
<td>Reported since 09/01/10</td>
</tr>
<tr>
<td>DOLLAR</td>
<td>Reported</td>
</tr>
<tr>
<td>THRIFTY</td>
<td>Reported</td>
</tr>
<tr>
<td>ENTERPRISE</td>
<td>Reported since 04/30/2010</td>
</tr>
<tr>
<td>NATIONAL/ALAMO</td>
<td>Reported</td>
</tr>
</tbody>
</table>
CONCLUSIONS AND OBSERVATIONS:

AUDIT OBJECTIVES 1 & 2

Gross Revenues were under-reported by not including a revenue product titled “Prepaid Fuel”. Prepaid Fuel is a flat amount purchased at the beginning of the rental based on a full tank of gas for which a customer is charged whether or not any gas is used. Thus the resulting concession fee calculated and paid to the City of Houston was not accurate. (NOTE: The results of testing associated with the original scope of June, 2011, was $74,930)

Criteria:
Contract Language

The Agreement lists revenue included or excluded from Gross Revenue. Article 3.1.12 of the Agreement states Gross Revenue means all revenue paid or payable and all compensation received by operator in connection with its Automobile Rental Business provided for herein, including without limitation the following:

- All sums received in connection with Automobile rentals for mobile phones, child restraint devices, and any other amenities
- All sums received for drop-off charges, valet charges, or any other charges identified on a customer’s automobile rental agreement (Article 3.1.12.5)
- All sums received for services rendered in connection with Operator’s Automobile Rental Business (Article 3.1.12.6)

Prepaid Fuel is considered to be an included item in Gross Revenues under the above listed Articles. In addition, Article 3.1.12 lists explicit exceptions (seven amounts that are not included) to Gross Revenue and Prepaid Fuel is not listed. The only gas related exclusion is Article 3.1.12 (iv):

- Any charges collected from customers as reimbursement for refueling an Automobile rented pursuant to a rental agreement under which the customer is obligated to return the Automobile with the same amount of gasoline furnished at the time of rental. NOTE: Prepaid Gas is not included in this exclusion.

Finding:

As noted in the AUDIT SCOPE MODIFICATION section, the Audit Team expanded testing and requested additional revenue information for the periods going back to September 2003. Avis/Budget’s management subsequently provided the City with actual gross revenues for Prepaid Fuel both locations (IAH/Bush Intercontinental Airport and HOU/Hobby Airport).

- The total unreported gross revenues for Pre-Paid Fuel was $13,444,371, which results in an underpayment of concession fees to the Houston Airport System of between $1,592,642 and $1,641,694 for the period between 2003 and April 2012 (See table 2 and 3 in the report). Because the contract continues through 2027, this also results in an estimated future benefit of approximately $2,741,629² for a total of additional payments and savings of $4.4 Million to the City.
- As noted in Table 1, Hertz had unreported revenues for the period of FY2008 through FY2010. The unreported gross revenues were $5,906,681, yielding an additional concession payment due to the City of between $504,617 and $645,923.
- The total amount owed to the City is $2,287,617 and a total savings with future benefits of $5,028,246 from the two largest rental car groups.

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² Calculation: Additional Payment of $1,641,694 (2003-2012) * 1.5 (remaining 15 years of contract) = $2,741,629
Office of the City Controller
Audit Division

**TABLE 2 - Total Under-Reported Gross Revenues**

<table>
<thead>
<tr>
<th>Total Revenue</th>
<th>$13,444,371.80</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$1,344,437.18</td>
</tr>
<tr>
<td>Underpayment of Concession Fees per</td>
<td>$1,344,437.18</td>
</tr>
</tbody>
</table>

**Table 3 - Total Concession Fee Owed to City of Houston**

<table>
<thead>
<tr>
<th>Total Unreported Pre-Paid Fuel Gross Revenue</th>
<th>Applicable Concession Fee Owed to the City</th>
<th>Associated Interest</th>
<th>Total Concession Fee Owed to the City With Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>$13,444,371.80</td>
<td>$1,344,437.18</td>
<td>Scenario A</td>
<td>$248,204.78</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Scenario B</td>
<td>$297,256.56</td>
</tr>
</tbody>
</table>

| Scenario A | Annualized the actual monthly payments to a lump sum for each year; and then calculated the FV of each year’s principle using the nominal treasury rate effective at that time; for the number of periods to date for each one; then aggregated the results. |
| Scenario B | Calculated an average monthly income stream ($11,203.64) owed to the city based on the total unreported revenue for the whole period; and applied the treasury rate effective at the beginning of the contract period to the total period to calculate lump sum in today’s dollars. |

**Recommendation:**
- HAS should obtain from Avis recalculated concession fees due HAS since 2003 for Prepaid Fuel and related items.
- HAS should verify that future monthly sales reports for concession fees include Prepaid Fuel, Overdue Surcharge, and the actual Vehicle License Fee revenues.

**Management Response:**
See Exhibit 1

**Assessment of Management Response:**
The management response provided by the vendor doesn’t adequately remediate the issue.
Audit Objective 3

Avis has not provided an irrevocable letter of credit for $857,152 to HAS. Avis is required to provide the City Performance Security consisting of a performance bond and an irrevocable letter of credit per Article 4.14 of the Agreement. Avis has provided the bond but has not provided an irrevocable letter of credit. HAS management has indicated that the irrevocable letter of credit does not exist and the performance bond satisfies the surety requirement. (Audit Objective 3).

Recommendation:
- If an irrevocable letter of credit is not required, the Agreement should be amended to remove this requirement.
- If it is determined that the letter of credit is required, HAS should obtain from AVIS the irrevocable letter of credit.
- HAS should implement procedures to obtain updated irrevocable letters of credit on an annual basis.

Management Response:
Management did not comment.

Audit Objective 4

Avis was in compliance with the CFC remittance requirements.

Acknowledgement and Signatures

The Audit Team would like to thank:
- Experis Professional Services Firm, specifically Mr. Ronald Penner for a significant contribution in identifying key contract terms and performing the majority of substantive work that yielded evidence that supported initial conclusions.
- Houston Airport System for their time and efforts in providing information and coordinating some of the communication.
- Legal Department for their expertise in contract interpretation and support in enforcing terms and conditions that protect the interests of the City stakeholders.
- Avis/Budget for their cooperation in providing information throughout the course of this audit.

David Schroeder, CPA, CISA
City Auditor
Office of the City Controller
Houston, TX