



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER


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AUDIT FOLLOW-UP MEMORANDUM

DATE: April 13, 2010

TO: John Martin, Airport Director

FROM: Tonia Lediju, Director of Audits, City Services Auditor 

SUBJECT: Results of Follow-up Review for Audit of The Hertz Corporation

EXECUTIVE SUMMARY

The Controller's City Services Auditor (CSA) Division issued an audit report on June 13, 2008, titled, *Concession Audit of The Hertz Corporation*, on which it followed up in writing in 2009. In response to our follow-up of the report's 11 recommendations, the Airport Department (Airport) indicated that it disagreed with two recommendations, fully implemented eight, and partially implemented one.

CSA assessed evidence of the Airport's implementation of the 11 recommendations, and determined that two were no longer applicable, eight were fully implemented, and one was partially implemented. The Airport's actions to implement the recommendations are summarized on pages 2 and 3, and the recommendations themselves and the implementation status of each are presented in the attached table.

BACKGROUND & METHODOLOGY

The Hertz Corporation (Hertz) had a 10-year agreement with the Airport Commission of the City and County of San Francisco (City) to operate an automobile rental service at the rental car facility at San Francisco International Airport. Although the agreement expired on December 29, 2008, the Airport Commission and Hertz entered a new five-year agreement, which expires on December 31, 2013. The agreement requires Hertz to pay the Airport the greater of a minimum annual guarantee or 10 percent of its gross revenues. The minimum annual guarantee was \$676,908 from the start of the prior agreement through December 29, 2003, and was modified to \$609,218 for the period through the expiration of the prior agreement.

In accordance with Government Auditing Standards, Section 8.05, promulgated by the United States Government Accountability Office (GAO), CSA conducted a follow-up review of the agreed-upon recommendations for the audit report of June 13, 2008, *Concession Audit of The Hertz Corporation*. Section 8.05 states that the purposes of audit reports include facilitating follow-up to determine whether appropriate corrective actions have been taken. This follow-up determined whether the Airport has taken the corrective actions needed to implement the audit report's recommendations. In the case of recommendations

calling for new procedures, CSA both verified that the procedures were created and considered examples of the department's compliance with them.

To conduct the follow-up, CSA contacted key Airport personnel to discuss the status of the corrective actions taken to date, verified the existence of the procedures and processes that have been established, and documented the results of the fieldwork.

RESULTS

In its March 2009 follow-up response to the audit report, the Airport reported that of the eleven recommendations, it disagreed with two recommendations, fully implemented eight, and partially implemented one, giving specific information for each recommendation (see attached table). CSA considered the information the Airport provided, reviewed supporting documentation, and verified that eight recommendations have, in fact, been implemented and one partially implemented. The Airport disagreed with two recommendations based on its interpretation of a lease agreement provision between Hertz and the Airport, which differed from the audit team's interpretation. Subsequent to this audit, the lease agreement expired and the Airport Commission and Hertz entered a new lease agreement, which included a revised definition of gross revenues which both the Airport and the audit team interpret similarly.

The results are presented below by subject area.

Recommendations 1 and 4: Collect From Hertz Local Rental Fees of \$518,371 and Commercial Discount Fees of \$295,594

The Airport disagreed with these two recommendations.

Conclusion: Since the Airport disagreed with these two recommendations, it did not collect these fees from Hertz. Therefore, the recommendations are no longer applicable. However, the new lease agreement between Hertz and the Airport Commission clarifies the definition of gross revenues subject to fees.

Recommendations 2, 3, and 5: Collect From Hertz Employee Business Rental Fees of \$5,106, Satellite Radio Rental Fees of \$7,145, and Revenue Adjustment Fees of \$72,058

As recommended, Airport collected these fees from Hertz in January 2009.

Conclusion: Recommendations 2, 3, and 5 have been implemented.

Recommendation 6: Review Hertz's Account to Determine How the Application of the \$270,764 Credit Failed to Result in an Outstanding Credit Balance if Hertz Paid the Full Monthly Fee for the Months in Question

The former accounting manager reviewed Hertz' account and determined that the annual true-up process captured any appropriate credits, and that the \$270K credit was simply a correction to the accounting system to reverse the initial erroneous entries.

Conclusion: Recommendation 6 has been implemented.

Recommendation 7: Collect From Hertz Interest of \$494,255 and Audit Costs of \$87,300

Since the Airport disagreed with recommendations 1 and 4, it recalculated, adjusted, and collected interest of \$43,935. Also, as a result of the reduction of fees owed, the Airport was no longer required to collect the \$87,300 cost of the audit.

Conclusion: Recommendation 7 has been implemented.

Recommendation 8: Document the Dates the Airport Receives the Certified Annual Reports of Gross Revenues

The Airport began using a property management billing system software package in the fall of 2008, which features, among other things, a tickler system. This will help the Airport ensure that reports are presented on time. Further, Airport Revenue Development and Management staff will review Annual Certified Statements for correct format. However, Hertz forwarded the 2008 certified year-end statement to the Airport and the Airport documented its receipt on April 2, 2009, or two days late.

Conclusion: Recommendation 8 has been implemented. However, the Airport should ensure that it receives its certified year-end statements before March 31st, as required by the agreement.

Recommendation 9: Work With Hertz to Determine the Fees Owed From Local Rental Revenue, Employee Business Rental Revenue, Satellite Radio Revenue, Commercial Discount Deductions, and Adjustment Deductions for the Period Before and After the Audit Period

The Airport collected from Hertz fees owed from satellite radio rentals for the relevant periods before and after the audit period. However, no fees have been collected for employee business rental revenue or for adjustment deductions. Since the Airport disagreed with recommendations 1 and 4 on local rentals and commercial discounts, it did not collect any fees for these revenue types.

Conclusion: Recommendation 9 has been partially implemented.

Recommendations 10 and 11: Require Hertz to Include in Gross Revenue Local Rentals and Satellite Radio, and to Discontinue Deducting Employee Business Rentals, Commercial Discounts, and Adjustments from Gross Revenues. Include in the New Agreement with Hertz a Comprehensive Definition of Gross Revenues and Exclusions to Gross Revenues

The Airport now has a new lease agreement with Hertz, which became effective on January 1, 2009. The new lease does include an all-inclusive definition of gross revenues. It also includes a few very clearly stated deductions. Any transaction that is not specifically allowed as a deduction will be considered gross revenues for which fees will be assessed.

Conclusion: Recommendations 10 and 11 have been implemented.

CSA extends its appreciation to you and your staff who assisted with this follow-up. If you have any questions or concerns, please call or e-mail Audit Manager Elisa Sullivan at (415) 554-7654 or ***elisa.sullivan@sfgov.org***.

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ATTACHMENT A: FINDINGS AND RECOMMENDATIONS

Audit Report Rec #	Recommendation	December 2009 Status Per Airport	Auditor's Follow-up Work	Results
1	The Airport Department should collect from Hertz the following fees owed: local rental fees of \$518,371.	Under the Lease, Hertz must pay "Gross Revenue" for "all vehicles rented at the Airport." (Lease Article 3.01.a) The Lease defines vehicles rented at the Airport if "the rental car <i>customer is an air passenger</i> who rents a vehicle within 24 hours of arriving at the Airport." (Lease Article 30.1.a.iii) Taken together, the Airport interprets this language to require Hertz to only calculate gross revenue for those vehicles rented by air passengers arriving at the Airport within 24 hours. Thus, Hertz is not required to calculate gross revenue for certain "Local Rentals," those customers who are not air passengers arriving within the last 24 hours. Provided Hertz adequately documents these "Local Rentals," the Airport considers said rentals as not included in the calculation of gross revenue.	Not applicable, since the Airport disagreed with the recommendation. However, the new lease agreement between Hertz and the Airport Commission, which became effective January 1, 2009, clarifies the definition of gross revenues subject to fees.	Not applicable.
2	Collect from Hertz the following fees owed: employee business rental fees of \$5,106.	Completed.	Obtained copy of payment check.	Implemented.
3	Collect from Hertz the following fees owed: satellite radio rental fees of \$7,145.	Completed.	Obtained copy of payment check.	Implemented.

Audit Report Rec #	Recommendation	December 2009 Status Per Airport	Auditor's Follow-up Work	Results
4	Collect from Hertz the following fees owed: commercial discount fees of \$295,594.	The Airport has consulted with the City Attorney's Office and believes the language stated in Lease Article 3.01.a, "without deduction or offset" does not include any commercial or promotional discounts offered by Hertz to third parties. While the language may cause confusion, the Airport maintains that Hertz must pay Gross Revenues based on the amount received.	Not applicable, since the Airport disagreed with the recommendation. However, the new lease agreement between Hertz and the Airport Commission, which became effective January 1, 2009, clarifies the definition of gross revenues subject to fees.	Not applicable.
5	Collect from Hertz the following fees owed: revenue adjustment fees of \$72,058.	Completed.	Obtained copy of payment check.	Implemented.
6	Review Hertz' account to determine how the application of the \$270,764 credit failed to result in an outstanding credit balance if Hertz paid the full monthly fee for the months in question.	Completed.	The Airport confirmed that it had reviewed Hertz' payment history shortly after the audit was completed in June 2008, and is confident that the credit was properly accounted for as a correction to the initial erroneous entries.	Implemented.
7	Collect from Hertz interest of \$494,255 and audit costs of \$87,300.	Hertz paid an adjusted amount for interest based upon the comments above. Collection of audit costs are no longer required based on the reduced amount collected.	Obtained copy of payment check. Verified that Hertz paid \$43,935 interest on an adjusted amount, which does not include the two amounts (\$518,371 and \$295,594) in recommendations 1 and 4 that the Airport did not agree with.	Implemented.

Audit Report Rec #	Recommendation	December 2009 Status Per Airport	Auditor's Follow-up Work	Results
8	Document the dates that it receives the annual reports of gross revenues and ensure the annual reports are certified by a certified public accountant as required by the lease.	Completed.	Obtained sample of screen print of billing system tickler. Also, obtained documentation of the Airport's receipt of Hertz' 2008 certified report on April 2, 2009, or 2 days late. The lease agreement requires that Hertz submit its certified annual report by March 31st of each year.	Implemented, but the Airport should ensure that it receives its certified annual report by the required date.
9	Work with Hertz to determine the fees owed from local rental revenue, employee business rental revenue, satellite radio revenue, commercial discount deductions, and adjustment deductions for the periods before and after our audit period.	This process is underway.	The Airport disagreed with collection of local rental revenue and commercial discount deductions (see recommendations 1 and 4), so it did not request payment for those amounts. In October 2007, Hertz remitted satellite fees for the periods November 15, 2002, through December 29, 2002 (satellite fees did not exist prior to November 15, 2002) and January 1, 2006, through September 30, 2007 in the amount of \$6,872.75 and then began paying it monthly beginning October 2007. The Airport has requested, but Hertz has not provided, documentation to show that Hertz submitted (or does not owe) fees for employee business rental revenue or adjustment deductions for the periods before and after the audit period.	Partially Implemented.
10	Require Hertz to include in gross revenues local rentals and satellite radio, and to discontinue deducting employee business rentals, commercial discounts, and adjustments from gross revenues.	Completed.	Obtained new lease that became effective January 1, 2009. Found that it does include an all-inclusive definition of gross revenues. Gross revenues does exclude all non-revenue rentals made to Hertz employees.	Implemented.

Audit Report Rec #	Recommendation	December 2009 Status Per Airport	Auditor's Follow-up Work	Results
11	Include in its new agreement with Hertz a comprehensive definition of gross revenues and exclusions to gross revenues that both parties agree to and understand.	Completed.	Obtained new lease that became effective January 1, 2009. Found that it does include an all-inclusive definition of gross revenues and exclusions to gross revenues that both parties agreed to.	Implemented.