Metropolitan Nashville Airport Authority

MEMORANDUM

TO: **Marge Basrai, Vice President and CFO** Basrai 8/23/18

IN TURN: **Douglas E. Kreulen, President and CEO** DEK 9/21/18

CC: **Margaret Martin, AVP of Business Development**

FROM: **Julie Zwicknagel, Internal Audit Coordinator**

REVIEWED BY: **Margaret Martin, AVP of Business Development**
Marge Basrai, Vice President and CFO

DATE: **June 29, 2018**

SUBJ: **Delaware North Companies Travel Hospitality Services, Inc. ("DNC") Audit Report**

Summary of Audit Results

In-Compliance

1. Gross revenue amounts reported and fees paid by DNC to the Authority were properly stated.
2. DNC demonstrated compliance with the following contract terms and operational requirements:
    a. Operational hours, based on review of Business Development records showing no documented issues.
    b. Operator staffing requirements for at least one full-time, dedicated, on-site concession manager and two full-time, dedicated, on-site assistant concession managers.
    c. Requirement to conduct formal performance audits on a bi-monthly basis.
    d. Quarterly and annual reporting requirements, based on DNC providing the authority with:
        i. Reports of concessions trends, sales projections and operational goals.
        ii. Reports of annual customer service improvement initiatives, customer complaints and secret shopper. NOTE: The contract terms do not include performance targets for customer service levels.
    e. Requirement to participate in monthly meetings with Authority personnel.
    f. DBE participation percentage requirements.

g. Commercial general liability (“CGL”), property, auto and worker’s compensation insurance.
h. Drug-free workplace requirements.

3. Adequate internal controls were in place by DNC.

Non-Compliance

1. Cyber liability certificate of insurance was not on file and a system for monitoring was not in place, as noted in finding #1.
2. Letter of Credit (“LOC”) coverage was $258,425 below amount required by contract and a system for monitoring was not in place, as noted in finding #2.

Contents of Audit Report

Audit Objectives

The objectives of the audit were as follows:

1. Determine the validity of gross revenue amounts reported and fees paid to the Authority;
2. Determine compliance with contract terms and operational requirements; and
3. Document and evaluate existing internal controls.

Background

On October 17, 2006, DNC entered into a Master Lease and Concession Agreement with the Metropolitan Nashville Airport Authority ("Authority") for the operation of Package 1 of the food and beverage concession at the Nashville International Airport. The term of the Agreement commenced on January 31, 2009, the beginning of the Operational Phase, and would continue for eight (8) full lease years (6/30/2017) with two one-year renewal options.

Concession Package No. 1 consisted of the following restaurants, categories of operations, concession locations, and square footage:

Restaurant	Category of Operation	Concession Location	Location within Terminal	Square Footage
Manchu Wok, Villa Pizza & Wendy's	Fast Food	AB-1	Concourse A/B Apex	2,247 sq. ft.
La Hacienda	Locally Themed Cafe/Lounge	A-2	Concourse A	1,620 sq. ft.
Swett's/Whitt's/Tootsie's	Locally Themed Cafe/Lounge	C-3	Concourse C	3,819 sq. ft.
O'Charleys	Casual Dining Restaurant and Lounge	C-7	Concourse C	4,567 sq. ft.
Tootsie's	Locally Themed Cafe/Lounge	PS-1	Pre Security	641 sq. ft.
Total Square Footage of Concession Package No. 1				12,894 sq. ft.

DNC agreed to pay to the Authority the greater of a minimum annual guarantee ("MAG") of One Million One Hundred Seventy-Five Thousand and No/100 Dollars ($1,175,000) or an amount equal to the applicable percentage of gross receipts from concession operations from each concession location. The applicable percentages of gross receipts are as follows:

1. Twelve percent (12%) of gross receipts derived from the sale of food & non-alcoholic beverages at fast food shops and locally themed café/lounges;
2. Fifteen percent (15%) of gross receipts derived from the sale of alcoholic beverages at fast food and locally themed café/lounges;
3. Ten percent (10%) of gross receipts derived from the sale of food & non-alcoholic beverages at the casual dining restaurant and lounge;
4. Fifteen percent (15%) of gross receipts derived from the sale of alcoholic beverages at the casual dining restaurant and lounge; and
5. Fifteen percent (15%) of gross receipts derived from the sale of related merchandise at all locations.

Within sixty (60) days after the end of each lease year, Concessionaire would provide to the Authority an annual report along with a reconciliation and payment to Authority (if any is due) as follows: (A) a comparison of the MAG for such preceding lease year and the percentage of gross receipts due to Authority for such lease year to determine the total amount owed to Authority by Concessionaire for such preceding lease year; and (B) payment of any additional amount owed as rent for such preceding lease year under the terms of the Agreement. In the event that such annual report reflects an overpayment by Concessionaire of periodic rent for such preceding lease year, Concessionaire would receive a credit by Authority for the overpayment with respect to subsequent periodic rent due to Authority or a refund, as Authority may determine. However, in no event would the Concessionaire take a credit against any subsequent periodic rent owed to Authority for any such overpayment without the prior written approval of Authority.

The Agreement stated that DNC would prepare monthly, quarterly and annual reports of gross receipts derived from the concession program, separately listing gross receipts by concession operator, concession location and type of concession operations. Annually, within ninety (90) days after the end of each lease year, Concessionaire would furnish Authority with audited statements of gross receipts derived from the concession program certified to by an independent public accounting firm.

DNC agreed to contribute to the Joint Marketing Fund (“JMF”), on a monthly basis, an amount not to exceed three quarters of one percent (0.75%) of all gross receipts derived from concession operations within the premises, effective January 31, 2009.

Additionally, DNC would pay to the Authority, on a monthly basis, Common Area Maintenance (“CAM”) charges in an amount equal to one and twenty-five one-hundredths (1.25%) of the gross receipts from concession operations. The CAM charges assessed would be used to reimburse the Authority for expenses incurred to provide general maintenance and upkeep of the common areas including cleaning, repair, refurbishment, equipping, furnishing, and replacement of furnishings.

The Disadvantaged Business Enterprise (“DBE”) participation goal for the Agreement was established at fifteen and seven tenths percent (15.7%) or more of total gross receipts from concession operations that are attributable to the participation of Authority-certified DBEs in the concession program. DNC achieves DBE participation through sublease agreements with Bridgeman Foods (“Wendy’s”) and Transfare (“Popeye’s, Freshen’s and Nathan’s Hot Dogs”).

The First Amendment to the Master Lease and Concession Agreement, effective June 1, 2011, provided for the reconcepting of approximately 1,463 square feet in the AB-1 Food Court for the operation of Popeye’s, Freshen’s, and Nathan’s Hot Dogs brands. The revised Concession Package No. 1 consisted of the following restaurants, categories of operations, concession locations, and square footage:

Restaurant	**Category of Operation**	**Concession Location**	**Location within Terminal**	**Square Footage**
Wendy's, Popeye's, Freshen's, and Nathan Hot Dogs	Fast Food	AB-1	Concourse A/B Apex	2,247 sq. ft.
La Hacienda	Locally Themed Cafe/Lounge	A-2	Concourse A	1,620 sq. ft.
Swett's/Whitt's/Tootsie's	Locally Themed Cafe/Lounge	C-3	Concourse C	3,819 sq. ft.
O'Charleys	Casual Dining Restaurant and Lounge	C-7	Concourse C	4,567 sq. ft.
Tootsie's	Locally Themed Cafe/Lounge	PS-1	Pre Security	641 sq. ft.
Total Square Footage of Concession Package No. 1				12,894 sq. ft.

The Second Amendment to the Master Lease and Concession Agreement, effective March 13, 2014, required DNC to sell and dispense beer and other alcoholic beverages under a liquor license held by the Authority.

The Third Amendment to the Master Lease and Concession Agreement, effective June 30, 2016, incorporated the Tennessee Brew Works Kiosk. The Agreement also included provisions for mobile food and beverage sales and cyber liability insurance.

The Fourth Amendment to the Master Lease and Concession Agreement, effective December 16, 2016, allowed DNC to sell retail alcoholic beverages.

On May 9, 2017, Business Development informed DNC through a Letter of Notification that the MAG would be adjusted to One Million Eight Hundred Thirteen Thousand Five Hundred Twenty-Five and 00/100 ($1,813,525), effective January 1, 2017.

On March 20, 2018, Business Development informed DNC through a Letter of Notification that the MAG would be adjusted to Two Million Forty Thousand Three Hundred Fifty-Two and 00/100 ($2,040,352), effective January 1, 2018.

The following are the gross revenues for DNC per the Schedule of Gross Revenues, JMF, and CAM Charges for the Year Ended December 31, 2017, provided by Tronconi Segarra & Associates LLP:

Schedule of Gross Revenues:

2017	Alcoholic Beverages	Food & Vending	All Other Retail	O'Charleys Food & Beverage	O'Charleys Alcoholic Beverages	Tennessee Beer Works Alcoholic Beverages	Wendy's Revenues	Popeye's Revenues	Freshen's Revenues	Mobile Revenues	Total
January	$267,301	$446,268	$1,876	$213,192	$91,031	$18,044	$96,377	$99,477	$26,628	$0	$1,260,194
February	263,456	433,049	1,665	213,973	95,373	18,307	88,392	89,924	25,976	-	1,230,115
March	325,580	537,840	3,066	283,508	128,648	25,152	113,844	119,779	36,975	-	1,574,392
April	342,789	538,364	3,939	281,930	129,677	28,300	100,195	115,668	35,883	37	1,576,782
May	365,353	586,283	3,648	296,779	137,322	27,602	120,865	123,932	37,868	179	1,699,831
June	360,495	591,837	4,450	311,610	142,300	31,246	129,811	147,169	42,642	437	1,761,997
July	327,150	545,437	4,100	286,376	122,562	24,101	125,561	147,441	41,686	630	1,625,044
August	350,098	531,465	3,467	287,402	141,053	30,583	121,357	134,701	36,480	451	1,637,057
September	354,424	519,037	4,316	263,705	129,589	29,209	115,347	127,419	33,438	693	1,577,177
October	390,708	611,399	2,646	312,328	149,202	33,082	127,155	142,481	40,284	606	1,809,891
November	364,804	545,395	3,266	287,639	136,585	29,141	116,340	138,006	35,459	718	1,657,353
December	343,159	504,961	3,370	287,029	129,831	26,009	120,379	135,753	31,728	863	1,583,082
Total Gross Revenue	$4,055,317	$6,391,335	$39,809	$3,325,471	$1,533,173	$320,776	$1,375,623	$1,521,750	$425,047	$4,614	$18,992,915
Contractual Percentage Rate	15%	12%	15%	10%	15%	18%	12%	12%	12%	5%	
Calculated Percentage	$608,298	$766,960	$5,971	$332,547	$229,976	$57,740	$165,075	$182,610	$51,006	$231	$2,400,414
Minimum Annual Guarantee											$1,813,525
Amount Paid by Delaware North											$2,400,414
(Under)/Over Payment											$0

Schedule of Gross Revenues and Joint Marketing Fees:

2017	Gross Revenues	%	Joint Marketing Fees
January	$1,260,194	0.75%	$9,451
February	1,230,115	0.75%	9,226
March	1,574,392	0.75%	11,808
April	1,576,782	0.75%	11,826
May	1,699,831	0.75%	12,749
June	1,761,997	0.75%	13,215
July	1,625,044	0.75%	12,188
August	1,637,057	0.75%	12,278
September	1,577,177	0.75%	11,829
October	1,809,891	0.75%	13,574
November	1,657,353	0.75%	12,430
December	1,583,082	0.75%	11,873
TOTALS	$18,992,915		$142,447
Total Joint Marketing Fees Due			$142,447
Joint Marketing Fees Paid by Delaware North			$142,447
(Under)/Over Payment of Joint Marketing Fees			$0

Schedule of Gross Revenues and CAM Charges:

2017	Gross Revenues	%	CAM Charges
January	$1,260,194	1.25%	$15,752
February	1,230,115	1.25%	15,376
March	1,574,392	1.25%	19,680
April	1,576,782	1.25%	19,710
May	1,699,831	1.25%	21,248
June	1,761,997	1.25%	22,025
July	1,625,044	1.25%	20,313
August	1,637,057	1.25%	20,463
September	1,577,177	1.25%	19,715
October	1,809,891	1.25%	22,624
November	1,657,353	1.25%	20,717
December	1,583,082	1.25%	19,789
TOTALS	$18,992,915		$237,412
Total CAM Charges Due			$237,412
CAM Charges Paid by Delaware North			$237,412
(Under)/Over Payment of CAM Charges			$0

According to the terms of the Master Lease and Concession Agreement, the Authority is due various percentages of revenues reported i.e., food and vending 12%, O'Charleys food and beverage 10%, alcoholic beverages 15%, and retail 15%. DNC's percentage payments from gross revenues were $2,400,414. Thus, the percentage payment paid to the Authority was greater than the MAG. The amount paid by DNC to the Authority for the Year Ended December 31, 2017, was $2,400,414. Therefore, there was no amount due either the Authority or DNC.

The JMF fees are a calculation based on 0.75% of total gross revenues. DNC's gross revenues for the Year Ended December 31, 2017, were $18,992,915. Thus, the amount due to the Authority was $142,447 and DNC paid $142,447 to the Authority for the JMF fees. Therefore, there was no amount due either the Authority or DNC.

The CAM charges are a calculation based on 1.25% of total gross revenues. DNC's gross revenues for the Year Ended December 31, 2017, were $18,992,915. Thus, the amount due to the Authority was $237,412 and DNC paid $237,412 to the Authority for CAM charges. Therefore, there was no amount due either the Authority or DNC.

The Authority's Finance Department determined on April 16, 2017, that DNC had fulfilled all percentage payment provisions required. Finance based the determination upon the MAG, percentage payment provisions, and the total amount paid by DNC to the Authority for the Year Ended December 31, 2017.

<u>Testing</u>

In order to satisfy the audit objectives, the following tests were performed:

1. Select 3 months for detailed testing (May, August, and October 2017). For each month selected, perform the following:
    a. Obtain the monthly fixed rent invoices from Authority's accounts receivable and verify that the invoiced amount agrees to the schedule of rental fees and charges in the Master Lease and Concession Agreements.
    b. Obtain monthly revenue report and perform the following:
        i. Review report for mathematical accuracy.
        ii. Tie amounts per report to amounts reported to the Authority.
        iii. Verify DNC had properly calculated the percentage of gross revenue requirements.
        iv. Verify monthly CAM charges were equal to 1.25% of the gross receipts from concession operations.
        v. Determine DNC was contributing 0.75% of monthly gross receipts to the JMF.
    c. Obtain a copy of the Tennessee sales and use tax forms.
        i. Review tax returns for reasonableness and determine taxes were properly remitted to the State.
2. Select 3 months for detailed testing (May, August, and October 2017) of a specific concession location (La Hacienda). For each month selected, perform the following:
    a. Obtain a copy of La Hacienda's general ledger and perform the following:
        i. Review report for mathematical accuracy.
        ii. Verify that the revenue amounts reported per the general ledger are consistent with the revenue amounts reported to the Authority.
        iii. Verify La Hacienda has properly calculated the percentage of gross revenue requirements.
        iv. Sub select a week each month and perform the following:
            1. Obtain the daily revenue report for the week selected.
            2. Verify the daily revenue amount agrees to the monthly general ledger report.
            3. Determine that the revenue was properly stated by noting sales receipts per the daily revenue reports contained appropriate information (e.g., sales date, total, method of payment, etc.)
            4. Review the daily revenue reports for any unusual activity.
3. Determine DNC is meeting operational requirements.
    a. Verify Concessionaire is meeting operational hours and staffing requirements.

    b. Determine Concessionaire is submitting a quarterly update regarding recent trends or developments in food and beverage concession operations.
    c. Verify Concessionaire is conducting formal performance audits on a bi-monthly basis.
    d. Determine DNC is meeting annual reporting requirements:
        i. Review Concessionaire's achievement of sales projections, financial results during the prior twelve (12) month reporting period.
        ii. Review operational goals and objectives for the forthcoming lease year.
        iii. Review Concessionaire's customer service improvement initiatives and activities including surveys, secret shopper programs, incentives, etc.
        iv. Review Concessionaire's customer service complaint summary during the prior twelve (12) month period.
4. Verify Authority personnel are conducting monthly meetings with Concessionaire to discuss operational issues.
5. Verify Concessionaire has met the DBE participation percentage requirements established in the contract.
6. Determine DNC maintains adequate insurance coverage.
    a. Obtain a copy of the current certificate of insurance on file.
    b. Verify that the CGL, property, automobile, and worker's compensation, liquor, and cyber liability insurance coverage meets or exceeds the amounts specified in the contract.
    c. Determine Business Development verified insurance companies were admitted to do business in the State of Tennessee and rated not less than the minimum credit ratings for insurance carriers.
    d. Verify the certificate of insurance is current and adheres to all other contract terms.
7. Determine DNC maintains an Irrevocable LOC.
    a. Obtain a copy of the current LOC.
    b. Verify that the LOC coverage meets or exceeds the amount specified in the contract.
    c. Verify that the LOC is current and adheres to all other contract terms.
8. Determine DNC is complying with drug-free workplace requirements.
9. Determine Concessionaire's sublease tenants submitted a Statement of Gross Revenues in a timely manner.
10. Through inquiry and observations, review the existing internal controls in place.

Audit Findings and Recommendations

Finding #1

Observation

Cyber liability certificate of insurance was not on file and a system for monitoring was not in place.

Requirement

According to Section 4.17, Privacy and Date Security, Item g, of the Third Amendment of the Master Lease and Concession Agreement, "Concessionaire shall obtain and maintain, at its expense, Cyber/Privacy/Network liability insurance/professional liability insurance coverage (the "Cyber Liability Coverage"), with a coverage limit of Five Million and No/100 Dollars ($5,000,000) per occurrence, that insures against cyber/privacy/network liabilities, including, without limitation, (i) Breaches and the liability arising from the loss or disclosure of Personal Information; and (ii) unauthorized access to or use of computer systems to include first-party coverage for forensic investigation, notification and credit monitoring."

An objective of the audit was to determine that DNC's certificates of insurance were current and adhered to contract terms. Through audit testing, it was determined on June 13, 2018, that Business Development did not have a cyber liability certificate of insurance on file for DNC. The cyber liability insurance was a requirement of the Third Amendment to the Master Lease and Concession Agreement, which was effective on June 30, 2016.

Additionally, Business Development does not have the cyber liability insurance coverage included in the Airport Business Management ("ABM") system as a contract requirement.

Recommendation

Business Development should require DNC to submit a cyber liability certificate of insurance.

Business Development should set up the cyber liability insurance coverage requirements in the ABM system as a contract requirement. Cyber liability certificate of insurance should be updated in ABM for all vendors, where required by contract.

After receiving DNC's cyber liability certificate of insurance, Business Development should set up an alert in the ABM system to monitor the certificate of insurance expiration dates to ensure that there are not any lapses in cyber liability coverages.

Management Response

Cause of Finding

Business Development did not ensure that new contract requirements arising from the contract amendment were tracked and implemented.

Corrective Action Plan

Business Development notified DNC on 8/13/2018 to submit a cyber liability certificate of insurance.

Business Development will set up the cyber liability insurance coverage requirements in the ABM system as a contract requirement, where applicable. Business Development will notify any other vendors missing a certificate to submit a cyber liability certificate of insurance and will update ABM, as applicable.

After receiving DNC's cyber liability certificate of insurance (as well as certificates from other vendors, as required), Business Development will set up an alert in the ABM system to monitor the certificate of insurance expiration dates to ensure that there are not any lapses in cyber liability coverages.

Corrective Action Plan Completion Date

ABM system updates (insurance requirements for vendors, and alerts) by 8/31/18. Accurate certificates received from all vendors by 9/15/18.

Controls to Prevent Recurrence

Business Development will implement monthly reporting from ABM on outstanding alerts or expired deadlines. Business Development will also be implementing a departmental audit schedule by agreement type to ensure that all agreement requirements are accurately captured in ABM, or another tracking tool if ABM is unable to track.

Controls Completion Date

Monthly reporting assignments complete by 10/15/18. Departmental audit schedule with staff assignments complete by 11/15/18.

Response Prepared By and Date

Margaret Martin, 8/13/18

Finding #2 (Repeat Finding FY 2016)

Observation

LOC coverage was $258,425 below amount required by contract and a system for monitoring was not in place.

Requirement

According to Article XIX, Financial Guarantee, Section 19.1, Letter of Credit, of the Master Lease and Concession Agreement, "As security for Concessionaires full, faithful and prompt performance of and compliance with all covenants, terms and conditions of this Agreement on the part of Concessionaire, Concessionaire hereby agrees to deposit with Authority, at all times from and after the Effective Date, a stand-by, irrevocable letter of credit (the "Letter of Credit") for the benefit of Authority, in the form of Exhibit I hereto, in a stated principle amount that is not less than fifty percent (50%) of the MAG hereunder for the then current Lease Year (or, for the period prior to the Commencement Date, in an amount that is not less than the minimum MAG for the initial full Lease Year), and issued by a national banking association or state chartered bank subject to examination by federal authority of the United States of America, of good standing and having a combined capital and surplus aggregating not less than Five Hundred Million and No/100 Dollars ($500,000,000). Concessionaire shall provide to Authority, not less than thirty (30) days prior to the expiration date of such Letter of Credit, a replacement Letter of Credit which meets the requirements of this Section 19.1. A Letter of Credit shall remain on deposit with Authority throughout the Term."

An objective of the audit was to verify the LOC was current and met or exceeded the amount specified in the contract. Through audit testing, it was determined that the LOC was current but did not meet the coverage amount specified in the contract.

The MAG assessed for 2017 was $1,813,525; therefore, the LOC coverage amount was required to be $906,763, as calculated below.

LOC Calculation	Amount
2017 MAG	$1,813,525
Percentage	x 50%
LOC coverage required	$906,763

The current LOC on file is in the amount of $761,751. Therefore, the LOC was underfunded in the amount of $145,012, as detailed below.

Description	Amount
Current LOC coverage	$761,751
2017 LOC coverage required per contract	906,763
Variance	($145,012)

On October 24, 2017, Business Development sent a letter requesting DNC to increase their LOC to $906,763. However, Business Development did not follow-up with DNC after the initial letter was sent to ensure there were not any lapses in LOC coverage requirements.

On March 20, 2018, Business Development adjusted DNC's MAG payment to $2,040,352. Therefore, the LOC coverage amount was required to be $1,020,176, as calculated below.

LOC Calculation	Amount
2018 MAG	$2,040,352
Percentage	x 50%
LOC coverage required	$1,020,176

The current LOC on file is in the amount of $761,751. Therefore, the LOC is underfunded in an aggregate amount of $258,425, as detailed below.

Description	Amount
Current LOC coverage	$761,751
2018 LOC coverage required per contract	1,020,176
Variance	($258,425)

On April 30, 2018, Business Development sent a letter requesting DNC to increase their LOC to $1,020,176. However, Business Development did not follow-up with DNC after the initial letter was sent to ensure there were not any lapses in LOC coverage requirements.

It should be noted that Internal Audit identified the same finding and made a similar recommendation in the Delaware North audit report dated June 15, 2016. Business Development's management response from that report was as follows:

"Business Development has notified DNC by a letter dated 6/13/2016, to increase their LOC coverage in the amount of $77,005 for a total coverage of $761,571. Business Development has reviewed and revised the alerts in the ABM system to better enable a timely review of LOC calculations and notifications."

Recommendation

Business Development should require DNC to increase their LOC coverage in the amount of $258,425 for a total coverage of $1,020,176.

Furthermore, Business Development should develop a process for following-up with Concessionaires within 30 days, after sending formal notification of not complying with contract requirements. Existing processes for MAG adjustments should be reviewed to ensure they include adjustments to LOC calculations.

Management Response

Cause of Finding

Business Development has no follow-up process when a notice is sent to a tenant or business partner.

Corrective Action Plan

Business Development has received an updated LOC from Delaware North.

Corrective Action Plan Completion Date

Completed as of 8/13/2018.

Controls to Prevent Recurrence

Business Development will create a process for following up when notices are sent to tenants or business partners. The follow up process should prevent recurrence of findings once drafted and implemented.

Controls Completion Date

Follow up process drafted by 10/15/18.

Response Prepared By and Date

Margaret Martin, 8/13/18