

Request for Decision

Audit Report - Transit and Community Arena Advertising Agreement

Presented To:	Audit Committee
Presented:	Tuesday, Aug 13, 2013
Report Date	Wednesday, Jul 24, 2013
Type:	Presentations

Recommendation

THAT this report BE RECEIVED for information and, THAT the action plans identified in this report BE RECOMMENDED for approval.

Signed By

Auditor General

Brian Bigger

Auditor General

Digitally Signed Aug 2, 13

SUMMARY

Background

- In 2010 the Auditor General's Office conducted an audit of Transit Services. Part of the scope of the Transit Services audit was to review various agreements which included the Transit Advertising Agreement. However, at the time the Transit Services audit was being conducted, the Transit and Community Arena Advertising Agreement had been awarded but there was no signed agreement to audit against. As a result, the Auditor General noted in the Conventional Transit audit report, that this agreement would be reviewed at a later date.
- Although the agreement was awarded in June 2009, the final terms of the agreement, and signing of the agreement was not completed until September 2010.
- A single Request For Proposal (RFP) was issued by the City of Greater Sudbury, on May 25, 2009, for an agreement granting exclusive advertising rights for both Greater Sudbury Transit and the fourteen Community Arenas.
- Exclusive advertising rights for Greater Sudbury Transit included the right to sell advertising on Transit buses, shelters, pedestrian benches and at the Transit Centre, in return for an annual license fee.
- Exclusive advertising rights for Greater Sudbury fourteen Community Arenas included the right to sell advertising on rink board surfaces, centre ice locations, ice re-surfacers, wall-sign boxes, exterior marquis sign boxes, electronic reader boards and advertising event boards, in return for an annual license fee.
- The exclusive advertising rights were awarded to The Sudbury Wolves Hockey Club Limited, operating as BK Corporate Marketing Services on June 24, 2009. Agreement terms were for five years, from August 1, 2009 to July 31, 2014 for Community Arena advertising and from January 1, 2010 to December 31, 2014 for Transit advertising. (Contract # CPS09-2)
- The Transit and Community Arena Advertising Agreement included an option for the City to renew for an additional five years.
- The administration of agreements in accordance with agreement terms and conditions was previously documented as a risk within Transit Services, during the Transit Kiosk audit.

Scope

· Administration of the Transit and Community Arena Advertising Agreement for the period of 2010, 2011 and 2012. (excludes an agreement with the Sudbury Wolves Hockey Club Limited for advertising rights within the Sudbury Arena^[1])

Objectives

- Determining whether appropriate value was obtained based on the amount of revenue received through these programs.
- Evaluating whether the program is following sound procurement practices.
- Determining whether the program produced intended results or produced results that were not consistent with the program's objectives.

Methodology

- We reviewed documentation related to the RFP process for the Transit and Community Arena Advertising Agreement, including: the addendum, information provided to the City by the plan taker, the bid submission, and the request for approval presented to Council.
- We reviewed the City's purchasing policies and procedures, the Procurement By-law and the Sign By-law.
- We reviewed the Transit and Community Arena Advertising Agreement and referenced the Sudbury Arena Agreement related to advertising rights.
- We also reviewed City records related to the agreement to ensure the agreement had been administered according to agreement terms and City By-laws in the interests of the taxpayers.
- We located the current agreements of other municipalities for Transit advertising through an internet search, and reviewed them in comparison to the City of Greater Sudbury agreement.
- Our review included an inventory taking and documentation of advertising in and on Transit buses, shelters, benches and Community Arenas throughout the City in the fall of 2012.
- We tested the accuracy and completeness for reporting of advertisements and related gross billings used in determining annual license fees (City's share of advertising revenues) as per the agreement terms.

GAGAS Compliance

We conducted our review in accordance with generally accepted government auditing standards. Those standards require that we adequately plan for the audit; properly supervise audit staff; obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions; and prepare audit documentation related to the planning, conducting, and reporting for each audit. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objectives.

Risks / Opportunities We Evaluated

- Contractor's adherence to terms and conditions of the Transit and Community Arena Advertising Agreement.
- City's administration of the agreement in accordance with agreement terms and City By-laws in the interests of the taxpayers.
- Accuracy and completeness of gross billings reported by the Contractor to the City, and used in determining annual license fees (City's share of advertising revenues).
- Validity and reasonableness of direct sales expense reported by the Contractor to the City, and used in determining annual license fees (City's share of advertising revenues).
- Accuracy of Contractors' calculation of annual license fees.
- Revenue opportunities for the City.
- The level of compliance with sound procurement practices, City policies and procedures during the RFP procurement process, the awarding of the agreement and establishment of agreement terms.

Elements Operating Effectively

- The exclusive advertising rights for Transit and Community Arenas were awarded through a competitive RFP process.
- The City's purchasing / procurement policy was followed.
- License fees were received in a timely manner.
- "Annual Statements" per paragraph 5.(2), for 2010, 2011 and 2012 were signed by a representative of BK Corporate Marketing Services, certifying to their accuracy.

Elements Not Operating Effectively

- Receipt of the "Annual Statement" per paragraph 5.(2), within 90 days of the 2012 fiscal year-end.
- Receipt of the "Yearly Statement" per paragraph 5.(1), for fiscal year-end in 2010, 2011 and 2012.
- Deduction of direct sales expense intended for new initiatives.
- Bundling of Transit and Community Arena Advertising rights into a single RFP and agreement.

Value For Money Considerations

- An opportunity exists to review the terms and conditions of the agreement as it relates to the deduction of direct sales expense in the determination of annual license fees.

OBSERVATIONS AND ACTION PLANS - 1

Administration of Transit and Community Arena Advertising Agreement

Observation

- The Transit Advertising Agreement describes a "Yearly Statement" in paragraph 5.(1). This "Yearly Statement" was intended to provide Transit and Arena administration with a listing of the advertisements approved and installed at municipal facilities and upon vehicles and other property owned or leased by the City, their respective installation dates, if applicable, and in the case of Transit advertising, the payment schedule for every advertisement.
- The auditors observed that a "Yearly Statement" was not provided to management in 2010, 2011 and 2012, and could have significantly increased the likelihood that reporting errors would have been identified by the Contractor or detected by City Staff.
- In accordance with the agreement, paragraph 5.(2), the City did receive an "Annual Statement" in 2010, 2011 and 2012, which was *certified of its accuracy* by the Contractor and reported gross billings by customer and total direct sales expense.
- These statements were relied upon as support for settlement of annual license fee remittances to the City. The lack of details in the "Annual Statements" received by management, made it difficult to verify the accuracy and completeness of reported advertising gross billings.
- Audit tests showed that the majority of errors found were due to inconsistent sales reporting methods being used (accrual vs cash basis of accounting).
- Audit tests also revealed advertising transactions where advertisers received the benefit of advertising during the year, where an agreement existed, and the transactions were not reported in the "Annual Statement".
- Although it is acknowledged that BK Corporate Marketing Services has exclusive rights to sell advertising, audit inquiry revealed a number of advertisements described as verbal agreements (contra, promotional, complimentary, etc.) where advertisers received the benefit of advertising during the year, no evidence of a written agreement existed, and the value of those agreements were not reported in the "Annual Statement".
- The audit revealed that the 2011 and 2012 "Annual Statements" submitted by the Contractor to the City contained a high level of accounting errors.

Business Impact

· *Based on our audit tests, after consideration of the net impact of gross billings adjustments, the errors found did not impact the amount of 2012 annual license fees already paid to the City.*

Action Plan

1. Meet with the Contractor in order to develop a proper sales tracking tool described as a “Yearly Statement” in paragraph 5.(1) of the agreement.
2. Monitor sales reported on this basis for the remainder of the base agreement period, and re-evaluate settlement minimums and formulas.
3. Assign staff responsibilities for key elements of contract administration and develop an internal procedure whereby the Contractor’s performance of agreement terms and conditions is monitored for compliance and evaluated for accuracy and completeness.

Management Comment

Management agrees with the recommended action plan and the plan has already been initiated.

Action Plan Lead

Manager of Transit Administration

Timing

- Staff has already contacted the Contractor regarding a proper sales tracking tool as described in paragraph 5.(1). Further meetings will take place in order to finalize the appropriate format.
- The new sales tracking tool will then be used to compare against the “Annual Statement”.
- The Manager of Transit Administration has been assigned the task of reviewing the terms and conditions of the contract for compliance, accuracy and completeness.

OBSERVATIONS AND ACTION PLANS - 2

Deduction Of Direct Sales Expense In The Determination Of Annual License Fees

Observation

- Although the agreement was awarded through a competitive process, there are potential compounding effects of awarding an agreement for terms over five years in an environment with little competition.
- Advertising services for Transit previously generated the greater of the minimum annual license fee of \$120,000 or 35% of annual gross revenue, for the agreement period ending December 31, 2009.
- As a result of the prices provided through the RFP process, advertising services for Transit were awarded to the Contractor with the greater of the minimum annual license fee of \$110,000 or 35% of annual gross billings less direct sales expense, for the agreement period ending December 31, 2010.
- According to management's report to Council[2] for approval of the contract award, the Contractor had advised the City that direct sales expense would be 18%. Each of the Contractor's 2010, 2011 and 2012 "Annual Statements" deducted a direct sales expense of exactly 25.0%.
- One of the challenges with the RFP Bid Form and Transit Advertising Agreement is that direct sales expense was not defined, nor limited by the agreement.

Transit Advertising Agreement Terms Applied In			2009
The City's Share Of Annual Transit Advertising Revenues			
Equal To The Greater Of (A) OR (B)			Actual
(A) Minimum Amount	(B) Annual Gross Revenue		100%
	X % Of Annual Gross Revenue		35%
(A) \$120,000	City Share Greater Of \$120,000 OR 35%		(B) 35%

Transit Advertising Agreement Terms Applied In			2010
The City's Share Of Annual Transit Advertising Billings			
Equal To The Greater Of (A) OR (B)			Actual
(A) Minimum Amount	(B) Annual Gross Billings		100%
	Less: Direct Sales Expense		18%
	X % Of Annual Net Billings		35%
(A) \$110,000	City Share Greater Of \$110,000 OR 26%		(B) 26%

- The amendment to the RFP Bid Form to allow for a deduction of direct sales expense was intended for investment in new advertising possibilities where revenues and direct sales expense was unknown such as electronic advertising on buses and / or advertising at the Transit Terminal. *These changes have not occurred.*
- If the 35% of gross billings less direct sales expense deduction was 18% as noted in management's report to Council, the effective rate (City's share of advertising revenues) would have been 29%. However, with the increase of direct sales expense to 25% that has been claimed, the City's share of advertising revenues has effectively been reduced to 26% of gross billings.
- Recognizing that the intended investment in new advertising possibilities has not occurred, the current net effective rate of 26% is 9% less than the previous rate of 35% of annual gross billings.

Business Impact

· *The annual impact of a 26% share vs a 35% share of gross billings would be \$9,000 per \$100,000 of Transit Advertising billings (where the minimum amount is exceeded).*

Action Plan

4. Eliminate the deduction for direct sales expense at the City's earliest opportunity and establish an appropriate percentage of gross billings and minimum annual license fee amount.

Management Comment

Management agrees with reviewing the terms of the agreement as it relates to direct sales expense.

Action Plan Lead

Director of Transit and Fleet Services

Timing

Discussion will occur with the Contractor and Legal Services immediately.

OBSERVATIONS AND ACTION PLANS - 3

Evaluating Procurement Practices

Observation

- Transit, Airport and Community Arena advertising were previously managed under one General Manager and Director. This is no longer the case.
- The Airport had been excluded in the 2009 RFP.
- The ability to offer advertising space in local Community Arenas to prospective Sudbury Arena advertising customers is specific to The Sudbury Wolves Hockey Club Limited, and has no significant benefit to other potential bidders for Transit advertising.
- Although the RFP process was constructed to allow a proponent to bid on either Transit or Arena advertising or both, the evaluation grid criteria point allotment may have discouraged bid submissions from advertising firms that were not geared to provide both Transit and Community Arena advertising services.
- Nine plan takers requested documentation supporting the RFP bid process for the agreement granting exclusive advertising rights for both Greater Sudbury Transit and the fourteen Community Arenas. However, only one bid proposal was submitted within the RFP deadline by The Sudbury Wolves Hockey Club Limited, operating as BK Corporate Marketing Services.

Business Impact

- *There is potential to increase competition from Contractors who specialize in different advertising segments.*

Action Plan

5. Transit advertising services should be separately contracted out (unbundled). Revise the process for issuing and awarding Transit and Community Arena Advertising Agreement with the objective of maximizing competition and potential advertising revenues for the City.

Management Comment

Management agrees with the unbundling of the agreement.

Action Plan Lead

Director of Transit and Fleet Services – Manager of Arenas

Timing

At agreement renewal or new RFP

[1] Exclusive advertising rights for the Sudbury Arena are described in a December 2002 report to Council.
http://www.greatersudbury.ca/content/static/nas/corpserv/Meetings/2002_Meetings/CouncilAgenda_Dec12_Part1.pdf

Those rights are provided in a separate agreement. According to the agreement with the Sudbury Wolves Hockey Club Limited which extends until 2022, no license fees will be recovered for the exclusive advertising rights for the Sudbury Arena.

[2] Management's report to Council recommending approval of contract award. (June 24, 2009)
<http://agendasonline.greatersudbury.ca/index.cfm?pg=feed&action=file&agenda=report&itemid=14&id=203>