2011-A08

Metropolitan Council

Program Evaluation and Audit

Metro Transit Advertising Contract

Financial Accounting and Process Audit

28 April 2011

INTRODUCTION

Background

Metro Transit’s current advertising contractor , Titan, LLC(Titan) was awarded a five-year contract beginning January 1, 2007 for the purpose of selling advertising on Metro Transit buses, trains, kiosks and other properties. Titan’s bid was selected as most advantageous from a field of five candidates in a competitive process. The contract terms include a revenue share of 60% of net advertising sales to Metro Transit and an increasing minimum annual guarantee (MAG) over the five years of the contract totaling $20 million dollars. During the first two years of the contract, Titan increased net advertising sales (15% in 2007 and 9% in 2008) generating $3.4 million and $3.8 million in revenue share to Metro Transit. This 60% revenue share for the first two years of the contract exceeded the minimum annual guarantees ($3.3 million in 2007 and $3.6 million in 2008) by $300,000. However, in 2009 Titan began to experience cash flow problems as a result of the steep decline in advertising spending brought on by the recession and earlier that year it notified all 44 of the transit agencies with which it had contracts that they would not be able to honor the $4 million minimum annual guarantees for 2009. Metro Transit stood to lose about $550,000.

Titan asked each of its clients, including Metro Transit, to renegotiate their contracts as part of a business restructuring. When this request was brought before the Council’s Transportation Committee, 41 of the 44 transit agencies had either reached tentative agreements with Titan to restructure their contracts or had awarded their contract to Titan again after a competitive bidding process. This included BART in San Francisco, MBTA in Boston, King County in Seattle, SEPTA in Philadelphia, NJ Transit and CTA in Chicago.

The proposed action to renegotiate the contract with Titan went before the Transportation Committee on January 11, 2010 in advance of the January 27, 2010 Council meeting. Believing that the proposed amendments to the Council’s contract (Contract) offered a comparative advantage to other contracts/agreements negotiated with other regions’ transit systems, the amendments to the contract were accepted.

Under the renegotiated contract the 2009 MAG was lowered from $4 million to $3,443,670 (the actual revenue share received). The 2010 and 2011 MAGs were also lowered; however, the revenue share percentages were increased for both of those years. A summary of these changes follows:

	Original Contract	Renegotiated Contract
Minimum Annual Guarantee 2009	$4.0 Million	$3,443,670
Metro Transit Revenue Share 2009	60%	60%
Minimum Annual Guarantee 2010	$4.4 Million	$3.0 Million
Metro Transit Revenue Share 2010	60%	63.5%
Minimum Annual Guarantee 2011	$4.7 Million	$3.3 Million
Metro Transit Revenue Share 2011	60%	65%

Metro Transit had budgeted $3.6 million in advertising revenue in 2010 and $3.7 million in 2011. Staff estimated that Titan would need to grow net sales revenues between three and four percent in 2010 and about five percent in 2011 to meet budgeted advertising revenues. Staff believed this growth would be attainable based on the introduction of two new LRT stations.

The current contract terminates on December 31, 2011 (or until all payments provided under the contract are made). The Council has the option to extend the contract through FYs 2012, 2013, and 2014 in one year increments. If the Council decides to extend the contract, the revenue share will continue at 65%, and the MAG will be calculated using the following method: projected net revenue (less commission) x 65% (revenue share) x 85%.

Purpose

The purpose of this review was to determine if Titan has honored the terms of the renegotiated contract, and to determine if necessary processes and procedures have been instituted to ensure fulfillment of the contract obligations. This review also identifies areas of potential risk.

Scope

The evaluation included a review of 2010 transit advertising revenues and financial reporting. It also considered competitors' reports of outdoor advertising growth in the Twin Cities region. A random sample of the accounts active in 2010 were selected for in-depth analysis.

Methodology

To understand fulfillment of the amended Contract by Titan and national advertising trends, the following methods of inquiry were used:

- *Interviewed Metro Transit Marketing and Finance department personnel.*
- *Reviewed Metro Transit financial information using a random sample of contracts active in 2010.*
- *Compared revenues received from Titan against the terms of the contract.*
- *Examined Titan's financial reporting processes.*

Internal Audit manually selected all the contracts that were active during any day in 2010. Because Metro Transit Accounting records bus and rail financials separately, Audit opted to consider bus and rail advertising separately, though some clients purchased advertising space for both rail and bus media under the same contract. From this universe, 56 contracts were randomly selected. This means that, in some cases, the same contract is considered twice – once to consider rail advertising, and again to consider bus advertising. In other cases although a contract included advertising on both rail and bus, only one or the other's assets were considered. The number of contracts randomly selected achieves a 95% confidence interval, with a 5% margin of error/expected error. These contracts were examined for accounting accuracy, complete documentation, and general contact management.

For each contract selected, the amount of revenue due to Titan in 2010, and the revenue share due to the Council, was calculated prior to reviewing the financial records sent by Titan. After these amounts were calculated, the figures provided by Titan were compared.

Assurances

This audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* and the U. S. Government Accountability Office's *Government Auditing Standards*.

OBSERVATIONS

Revenues

Titan's revenue reports met contract requirements.

Titan, and similar advertising companies, uses a complicated accounting process. Titan bills its clients on a four-week basis. This four-week schedule does not align with the month-by-month payment schedule of revenues due to the Council per the Contract.

Titan provides the Council a document tracking the amount invoiced to the clients, and the amount the clients pay Titan. A check is sent each month to the Council equivalent to the net revenue collected for the previous month's sales multiplied by the 63.5% revenue share. Per the language in the contract, Titan is required to pay the revenue share to the Council based on receipts. If a Titan client defaults, Titan is not held liable for paying the corresponding revenue share to the Council. In 2009 Titan tracked the net *sales* per month, and calculated the revenue share due to the Council based on these sales. Beginning April 2010, Titan provided the Council documentation of both net sales and net revenue collected; however, payments to the Council were based on the net revenue collected.

The reporting provided by Titan with each payment to the Council meets all of the contractual provisions as required in §3.02 *Statement and Status Report* of the Contract.

Discounts from posted rates were properly recorded.

The four-week block contract is common in the advertising industry. Companies that specialize in transit advertising rely loosely on what is known as a "rate card." A rate card is used as a starting point for negotiations. Typically an advertising company will negotiate down from the four week rate as its client agrees to buy more weeks of advertising, a great quantity of advertisement (i.e. advertising on more buses), or more types of advertising (i.e. advertising on bus, rail, and transit shelters). Consistent with practice in the field of transit advertising, Titan's final rates are discounts from the rate card. According to the Contract, "*The CONTRACTOR shall notify the COUNCIL, in writing, of all discounts/allowances from posted rates.*" Titan has complied with this requirement.

End of year financial reports were accurate with one exception.

Titan's end-of-year financial reporting was accurate. The projected net revenues based on the contract specifications were very similar to the actual net revenues reported. Audit found one minor ($444) uncorrected error in calculation in the Excel document used by Titan to track the total amount of revenue due from its clients.

The Metro Transit Financial Analyst assigned to this account provided documentation of correspondence with Titan wherein she asked for clarification on financial misalignments, and on changes that did not match the terms of the contracts between Titan and its clients. As a result of her efforts the year-end financial reports were accurate.

Actual revenues were lower than forecasted.

When renegotiating its contract with the Metropolitan Council, Titan submitted revenue forecasts for 2010 and 2011. At the end of 2010, total sales were less than the forecast by $605,492, and the revenue share due to the Council on sales was $386,738 less than the forecast. Titan was able to surpass the MAG under the revised Contract by $198,337, as shown below.

Forecast 2010		Actual 2010	Difference
$5,642,307.00	Total Sales	$5,036,815.00	($605,492.00)
$3,585,115.00	Revenue Share	$3,198,377.00	($386,738.00)
$3,000,000.00	MAG	$3,000,000.00	$0.00

Council staff projected that Titan's 2010 sales should be able to grow at least three to four percent over 2009 sales based on the addition of two new light-rail stations, one being Target Field station. However; in 2009 Titan's sales were $5,315,463 and in 2010 they were $5,036,815, a decrease of 5.24%.

Metro Transit's budgeted revenue for 2010 included $3,636,544.00 from the Titan contract. This is $438,167 more than the revenue share of total sales for the year and $636,544 more than the MAG.

Terms of Payment

Minimum Annual Guarantee (MAG) Payment Process did not recognize 2010 revenues that were receipted in 2011.

Titan was not originally planning to submit a report indicating which accounts, active in 2010, had been paid in 2011. During the course of this audit, Titan agreed to submit reports on the 20th of each month showing which accounts due in 2010 have been paid in 2011 until all past due receivables have been collected.

Payments were made to the Council in accordance with the contract.

Under the amended contract, Titan is required to pay the MAG once annually. In the original contract, Titan was required to pay the MAG quarterly. In 2009, Titan was not able to pay the first quarter MAG. Metro Transit management expressed concern that under this new MAG payment schedule, Titan may be disposed to withhold portions of monthly payments throughout the year during times of financial duress. The first quarter was of particular concern based on the financial difficulties encountered by Titan in 2009.

To determine Titan's fidelity in paying the Council's revenue share in a timely manner, Audit examined the payments received versus the amount due per the sales records. According to the records provided by Titan, Titan pays the Council as payments from clients are received. The records provided by Titan do not include copies of dated checks received from clients, but self-reporting of when client payments were received. However, this reporting meets all of the contractual provisions as stated in §3.02 *Statement and Status Report of the Contract*.

Advertising sales reflect industry trend.

In general, sales in the beginning of 2010 were low. For example, January sales were only $122,321; a few months later, in March, sales were $436,328. This sales pattern reflects the experience of others in the industry. Audit's review of industry data found that advertising companies have a decline during the first quarter of the year and that there are increases in the second quarter. This pattern is repeated annually.

Contract Management

Multiple issues exist concerning Titan's third party contracting process. Audit reviewed 56 contracts that had been provided to Metro Transit by Titan. The issues that were noted in the contracts that were on file with Metro Transit are shown here:

Contracts on File at Council

Issue	Number of 56	Percentage
No Titan Signature	17	30.36%
No Client Signature	16	28.07%
No Signature without "Clarification" designation	13	23.21%
Designated "Metro Transit Clarification"	4	7.14%
Indicated See Purchase Order (no PO provided)	2	3.57%

Audit then requested copies of the original contracts, for those that were originally provided unsigned. The issues that remained are shown here:

Contracts on File at Titan

Issue	Number of 56	Percentage
No Titan Signature	5	8.93%
No Client Signature	6	10.71%
Contract Not Dated	5	8.93%
Signed After Start Date	4	7.14%
Purchase Orders Missing*	0	0.00%

*Titan provided PO's for two contracts provided to the Council with "See Purchase Order" indications

Discussion with the Council Financial Analyst assigned to this account revealed that Titan is not in the practice of keeping the Council notified of changes to contracts.

Titan often provides a written explanation of these changes after they appear on its financial records and often in response to a query from the Council's Financial Analyst assigned to the account. Over seven percent of sampled contracts were signed after the start-date of the advertising campaign.

According to Section 3.03 of the Contract as amended in 2010:

> *The CONTRACTOR shall provide the COUNCIL with copies of all advertising contracts, amendments to such contracts and cancellation notices for such contracts entered into by CONTRACTOR in connection with this Contract. Such copies shall be provided promptly upon their execution or effectiveness.*

Production cost changes are not reviewed by Metro Transit.

According to Section 8.01 *Record Keeping*:

> *"The CONTRACTOR shall also maintain the financial information and data used in preparation or support of the cost submission for any negotiated Contract amendment or change order and provide printed or copied documentation to the COUNCIL as requested."*

The Financial Analyst assigned to the Titan account confirmed that Titan does not provide a thorough explanation of why a production cost changes. No description of increased material costs, or increased costs for a third party who may print or produce the display chargeable to Titan, are provided; however, Metro Transit Personal have not explicitly requested the data.

Contract forms are not uniform or consistently utilized.

Titan uses several different forms and versions of forms for contracts. For example, for one contract, Titan sent the Council the "Contract for Advertising" form. When Audit requested a copy of the finalized forms, with signatures, Titan sent a copy of "Contract Instructions" which did display signatures. Furthermore, the Contract for Advertising does not have a designated space for the third-party client to date the form. The Contract Instructions form has a designated space for the third-party client to date the form.

Titan monitors advertising materials for content and appropriateness.

Titan is responsible for monitoring the media content for content appropriateness. According to the Market Development Supervisor, Titan has satisfactorily reviewed all materials for content appropriateness pursuant to "Appendix 2 Scope of Work" of the amended Contract, submitting materials that are even marginally questionable to her attention for review. Titan also submits the train and bus wrap creatives for review, thereby enabling the Market Development Supervisor to ensure that the specifications meet the standards for this type of advertising.

Metro Transit's Accounting Department has a significant role in management of the Titan account.

The Financial Analyst assigned to Titan noted that there had been some turn-over of personnel in Titan's staff between 2009 and 2010, around the time the contract was renegotiated. The new accountant at Titan, who is now working with the Council's Financial Analyst, had been unaware of many of the processes used in association with this contract.

Although Titan frequently makes errors in calculations and has room for improvement in the area of collection, it has been highly accommodating and receptive when the Council has contacted it to make corrections, ask questions, and request adjustments. Due to the nature of this account and the financial difficulties that Titan has had, the Metro Transit Accounting Department has had to assume a role that steps outside of simple accounting and into the realm of contract management when dealing with Titan.

CONCLUSIONS

Titan has complied with most aspects of its contract with Metro Transit. While the revenues are below projections the revenue trends are in line with the industry trends and they have exceeded the contractual MAG.

Titan has failed to provide the Council with timely notification of contract amendments or other changes in connection with the terms of their contracts with clients purchasing advertising space. Several of the client contracts do not have required signatures and dates and the actual contract forms are not used in a consistent manner.

While only one error was found in the accuracy of the year end reports there were a number of errors throughout the year that were corrected as a result of the careful financial management exercised by the Metro Transit Financial Analyst assigned to the Titan account.

Metro Transit's budgeted revenue from Titan exceeded the MAG, the forecasted revenue and the actual sales revenue.

Metro Transit maintains an appropriate level of oversight over the contract with one area of exception. Metro Transit hasn't explicitly requested information concerning production cost changes. Overall, Titan is reportedly receptive to process improvement suggestions, flexible, quick to respond to requests for information, and willing to seek out new means of generating revenue.

RECOMMENDATIONS

Program Evaluation and Audit recommendations are categorized according to the level of risk of the findings (conditions) they are designed to resolve.

- **Essential –** Steps must be taken to avoid the emergence of critical risks to the Council or to add great value to the Council and its programs. Essential recommendations are tracked through the Audit Database and status is reported twice annually to the Council's Audit Committee.
- **Significant –** Adds value to programs or initiatives of the Council, but is not necessary to avoid major control risks or other critical risk exposures. Significant recommendations are also tracked with status reports to the Council's Audit Committee.
- **Considerations –** Recommendation would be beneficial, but may be subject to being set aside in favor of higher priority activities for the Council, or may require collaboration with another program area or division. Considerations are not tracked or reported. Their implementation is solely at the hands of management.
- **Verbal Recommendation –** An issue was found that bears mentioning, but is not sufficient to constitute a control risk or other repercussions to warrant inclusion in the written report. Verbal recommendations are documented in the file, but are not tracked or reported regularly.

1. (Essential) Metro Transit should require Titan to provide signed and dated contracts and contract amendments in a timely manner. The contract should be standardized and used consistently.

Over thirty percent of contract copies provided to the Council did not have the required signatures. On some versions of the *Contract for Advertisement* no date of signature field was included. Titan rarely provided both versions of the form. Without a signed and dated contract, there is no legal relationship between Titan and its client. This presents risk to the Council in the event that Titan's client defaults on payments or otherwise violates the terms written in the unsigned contract. Utilizing a standardized contract form will simplify the contract management process.

Management Response: *Metro Transit will request that Titan use one standardized contract form that includes fields for dates and signatures. On a monthly basis, the Financial Analyst will analyze payments made by Titan to determine that all required documentation has been received from Titan and that all documents have the appropriate signatures and dates. If documents or signatures or dates are missing, Metro Transit Finance will notify Titan of the need for the missing documents or signatures, and will copy the Marketing Department on these requests. The Marketing Department will follow-up as needed.*

Staff: *Finance and Marketing*

Timeline*: Immediately*

2. **(Significant) Metro Transit staff should explicitly request cost data used in preparation or support of Titan's cost submission for any negotiated contract amendment or change order.**

The Financial Analyst indicated that Titan does not provide adequate documentation to substantiate changes in 'creatives' production costs. According to the contract, this documentation must be supplied by Titan, but only upon the request from the Council. For changes in creative costs, supportive documentation should be explicitly requested by Metro Transit personnel.

Management Response: *While processing payments from Titan and producing the monthly Advertising Report, the Financial Analyst will determine that any changes in production costs have been documented using the appropriate forms and that those forms are part of the Advertising Contract file. Metro Transit Finance and Marketing departments will explicitly request that Titan provide documentation to substantiate changes in production costs.*

Staff: *Finance and Marketing*

Timeline: *Immediate*

3. **(Consideration) Metro Transit consider basing the budget for revenue from the Titan contract on the amount of the MAG, rather than projected sales, in order to protect the Council against market risk.**

Metro Transit budgeted $636,544 more than the MAG for FY 2010. Actual revenue, while $198,377 more than the MAG, was $438,167 less than the budgeted revenue. Since the advertising industry has been suffering from a deep decline in sales and Metro Transit has seen the effects of the decline, it is fiscally prudent to budget for the MAG.