

# Metropolitan Nashville Airport Authority

## MEMORANDUM

**TO: Raul Regalado, President and CEO**

**CC: Monty Burgess, Senior Vice President and COO**  
**Stan Van Ostran, Vice President and CFO**  
**John Howard, Assistant Vice President of Properties and Business Development**  
**Tom Bibb, Director of Properties**  
**Rebecca Ramsey, Manager of Properties**  
**Amber Gooding, Director of Business Diversity Development**

**FROM: Basil A. Dosunmu, Internal Auditor**

**DATE: July 26, 2010**

**SUBJ: Hudson Group Audit Report**

---

### Background

On November 30, 2006, Airport Management Services, LLC (“Hudson Group”), a New Jersey Limited Liability Company entered into a Master Lease and Concession Agreement (A-07-248) with the Metropolitan Nashville Airport Authority (“Authority”). The Agreement granted Hudson Group the rights to operate news, gifts and specialty retail businesses at the Nashville International Airport for a period of eight (8) years, which commenced on January 31, 2009, the beginning of the Operational Phase and would continue until June 30, 2017, with two (2) one year renewal option.

Commencing after January 31, 2009, Hudson Group would pay to the Authority the greater of a minimum annual guarantee (“MAG”) in the amount of Two Million Three Hundred Forty Eight Thousand Nine Hundred Fifty and 00/100 Dollars (\$2,348,950.00), which is subject to an annual adjustment based on prior year rentals, or annual calculated percentage of payment of gross revenues derived from the sale of news, gifts and specialty concession businesses at the Airport. The following are the news, gifts and specialty retail business and percentage of gross revenues derived from Hudson Group.

<u>Concession Concepts</u>	<u>Concession Operations</u>	<u>% of Gross Revenues</u>
News & Conveniences	Hudson News & CNN	13%
Nashville Souvenirs	Discover Nashville, Nashville Kitchen & Nashville Star	15%
Bookstore & News	Hudson Booksellers	11%
Specialty Retail	CMT Loot, Fly Babies, Godiva Chocolatier, Harley Davidson, In Celebration of Golf, Kids Works, Life Is Good, Radio Road, Spirit of the Red Horse, & Sunglass Hut	12%

In addition to the MAG and/or percentage of gross revenues payments required, Hudson Group agreed to contribute to the joint marketing fund, on a monthly basis, an amount not to exceed three quarters of one percent (0.75%) of all gross revenues derived from concession operations.

As of March 31, 2010, the joint marketing fund balance is in the amount of \$389,589. The types of expenses that Authority may pay out of the joint marketing fund shall include, without limitation, the following:

- a) Direct costs associated with marketing and promotional activities (including, without limitation, costs incurred for the purchase of marketing program creative materials, costs for special events and/or paid media);
- b) Costs associated with marketing program development and the day-to-day coordination of the marketing program;
- c) Costs for development and provision of shopping bags to promote Concession Operations;
- d) Secret shopping and other inspection programs with respect to Concession Operations;
- e) Directory signage within the Terminal relating to the Concession Locations;
- f) The preparation of a full-color catalog featuring the Concession Operations, the Concession Locations and the products and services offered by Concession Operators, which may include coupons; and
- g) Other programs, such as brochures, common shopping bags, graphics, media promotions, pamphlets and public events, to promote sales through the Concession Program.

Likewise, Hudson Group is required to provide for a level of Authority-certified Disadvantage Business Enterprise (“DBE”) participation of fifteen and seven tenths percent (15.7%) or more of total gross revenues from Concession Operations. On May 18, 2006, Hudson Group entered into a Joint Venture Agreement with Olympic Supply, Inc, AMS–Olympic Nashville, JV to collaborate as joint venturers in the operation of retail concessions at Nashville International Airport. The interests of the Joint Venturers in the Joint Venture are as follows:

Hudson Group	83%
Olympic Supply, Inc.	17%

According to the Authority's Department of Business Diversity Development ("BDD"), Olympic Supply, Inc. is a minority owned firm certified by the Authority and the State of Maryland. In addition, Hudson Group entered into a sublease agreement with CBR, Incorporated ("CBR"), a woman owned DBE firm also certified by the Authority.

Furthermore, On January 15, 2007, Hudson Group entered into a Space Lease Agreement (A-07-252) with the Authority. This Agreement granted Hudson Group the right to use certain improved real property, commonly known as Support Space within the Passenger Terminal Building located on the Nashville International Airport, for the operation of the News, Gift, and Specialty Retail Concession Operation. The term of the Agreement was for the period of one month and shall be automatically renewed on a month-to-month basis.

Hudson Group agreed to pay the Authority annual rental amount of One Hundred Thirty One Thousand Two Hundred Fifty Six and 00/100 Dollars (\$131,256.00), payable in equal monthly installments, based upon \$36 per square foot ("sf") per annum.

The First Amendment to the Space Lease Agreement, effective April 1, 2007, provided for: (i) the deletion of storage rooms T2002B and T2027 located on the ticketing level of the main terminal and consisting of 1,922 square feet. Hudson Group agreed to pay the Authority annual rental amount of Sixty Four Thousand Six Four and 00/100 Dollars (\$62,063.00), payable in equal monthly installments, based upon \$36 per sf per annum.

On December 3, 2007, CBR informed the Authority that effective November 30, 2007, CBR has been sold to Host International, Inc. ("HMSHost"), an Autogrill Group, Inc. Company ("AGI"). The name of the new firm is CBR Specialty Retail Incorporated, which continued to oversee Airport operations with the same original management team.

On December 14, 2007, a letter from Hudson Group notified the Authority that Hudson Group entered into a strategic relationship with Advent International Corporation ("Advent"). The owners of Hudson Group agreed to sell a controlling interest of approximately 80% to Advent. Hudson Group continued to lead and manage the business along with its current management team. In addition, Hudson Group maintained that the terms and conditions of the Agreement shall remain and continue in effect.

The Second Amendment to the Space Lease Agreement, effective January 1, 2008, provided for: (i) addition of support space, rooms T0019 (199 sf), T0019A (525 sf) for a total of 898 sf and (ii) deletion of support storage space room T0027 (473 sf). Hudson Group agreed to pay the Authority annual rental amount of Seventy Seven Thousand Three Hundred Sixty Four and 00/100 Dollars (\$77,364.00), payable in equal monthly installments, based upon \$36 per sf per annum.

On September 4, 2008, a letter from Hudson Group notified the Authority that Hudson Group proceeded with the strategic relationship with Advent and has joined itself to Dufry AG, an Advent portfolio company. Advent controls Dufry AG; Dufry AG will directly own 100% of Hudson Group. There will be no changes in Hudson Group's day-to-day operation and management team at the Airport. Hudson Group re-affirmed that the terms and conditions of the Agreement shall remain and continue in effect.

The Third Amendment to the Space Lease Agreement, effective July 1, 2009, provided for: (i) addition of support space, rooms T2001G (208 sf), S1219 (298 sf), located on Level 3 of the main terminal and D Concourse; (ii) deletion of support space room T1051 (936 sf); and (iii) revision of the lease exhibit to accurately represent the space utilized by the lessee in the passenger terminal building. Hudson Group agreed to pay the Authority annual rental amount of Seventeen Thousand Two Hundred Ten and 00/100 Dollars (\$17,210.00), payable in equal monthly installments, based on \$10 per sf per annum.

On November 10, 2009, Olympic Supply, Inc. informed the Authority that its trade name has been changed to Onsite News but the corporate name (Olympic Supply, Inc.), ownership, and management of the corporation remained unchanged.

The Concession Agreement stated that Hudson Group would furnish audited statements to the Authority, prepared in accordance with generally accepted accounting principles that the MAG and the percentage payment paid by the Concessionaire to the Authority during the preceding contract year were made in accordance with the terms of the Agreement. The statement would contain gross revenues as shown on the books and records of Hudson Group that were used to compute the percentage payment made to the Authority.

In addition, within sixty (60) days after the end of each year, Hudson Group shall provide its annual report along with a reconciliation and payment to Authority, if any, due to the Authority for the preceding lease year on account of the percentage payment provisions. If any refund is due to Hudson Group, such refund would be applied to future rental payments due to the Authority.

The following are the gross revenues and percentage payment provisions for Hudson Group per the Statement of Monthly Gross Revenues and Concession Payments for the periods before and after the commencement date, provided by Marcum LLP:

<b>Hudson Group</b>							
<b>Pre-Commencement Date Gross Revenues (July 1, 2008 - January 30, 2009)</b>							
<u>Period</u>	<u>News &amp; Conveniences</u>	<u>Nashville Souvenirs</u>	<u>Bookstore &amp; News</u>	<u>Special Retail</u>	<u>DBE Subtenant</u>	<u>Subtenant</u>	<u>Total</u>
July 2008	\$477,031	\$39,074	\$441,479	\$371,496	\$1,174	\$110,947	\$1,441,200
August	326,875	60,732	394,493	446,839	992	116,104	1,346,035
September	279,448	72,350	345,772	374,389	854	133,471	1,206,284
October	313,686	81,349	390,565	406,264	907	127,400	1,320,172
November	284,858	68,750	349,028	358,096	769	115,660	1,177,162
December	303,471	63,891	350,747	307,074	685	116,197	1,142,065
January 2009	231,209	46,357	305,452	268,343	843	85,349	937,553
Total Gross Revenue	2,216,579	432,502	2,577,536	2,532,501	6,223	805,129	8,570,470
Contractual Percentage Rate	13%	15%	11%	12%	4%	12%	
Payment Due	\$288,155	\$64,875	\$283,529	\$303,900	\$249	\$96,615	\$1,037,324
Minimum Annual Guarantee							\$339,932
Rent paid by Hudson Group							\$1,043,204

Commencement Date Gross Revenues (January 31, 2009 - June 30, 2009)

<u>Period</u>	<u>News &amp; Conveniences</u>	<u>Nashville Souvenirs</u>	<u>Bookstore &amp; News</u>	<u>Special Retail</u>	<u>DBE Subtenant</u>	<u>Subtenant</u>	<u>Total</u>
February 2009	\$213,801	\$48,918	\$302,484	\$280,029	\$839	\$100,441	\$946,512
March	275,560	63,623	367,954	335,148	1,280	124,919	1,168,484
April	277,136	72,620	382,146	346,685	1,037	141,584	1,221,208
May	297,751	70,541	404,418	373,983	786	154,913	1,302,392
June	322,358	71,465	424,262	394,141	523	147,961	1,360,711
Total Gross Revenue	\$1,386,606	\$327,168	\$1,881,265	\$1,729,987	\$4,463	\$669,818	\$5,999,306
Contractual Percentage							
Rate	13%	15%	11%	12%	4%	12%	
Payment Due	\$180,259	\$49,075	\$206,939	\$207,598	\$179	\$80,378	\$724,428
Minimum Annual Guarantee							\$978,729
Rent paid by Hudson Group							\$978,729

**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.
3. Document and evaluate existing internal controls.

**Testing**

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

1. Selected 3 months for detail testing (January, March, and June 2008). For each month selected, performed the following:
  - a. Obtained the monthly fixed rent invoices from Authority's Accounts Receivable and verified that the invoiced amount agreed to the schedule of rental fees and charges in the Master Lease and Concession Agreements.
  - b. Obtained monthly revenue report and performed the following:
    - i. Reviewed report for mathematical accuracy.
    - ii. Tied amounts per report to amounts reported to the Authority.
    - iii. Verified Hudson Group had properly calculated the percentage of gross revenue requirements.
  - c. Obtained a copy of the Tennessee Sales and Use Tax forms.
    - i. Tied revenue amounts per sales and use tax forms to revenue amounts reported to the Authority.
2. Selected 3 months for detail testing (January, March, and April 2009) of a specific concession location News Book. For each month selected, performed the following:
  - a. Obtained a copy of News Book general ledger and performed the following:
    - i. Reviewed report for mathematical accuracy.

- ii. Verified that the revenue amounts reported per the general ledger were consistent with the revenue amounts reported to the Authority.
  - iii. Verified News Book had properly calculated the percentage of gross revenue requirements.
  - iv. Sub selected a week each month and performed the following:
    - 1. Obtained the Daily Revenue Reports for the week selected.
    - 2. Verified the daily revenue amount agreed to the monthly general ledger report.
    - 3. Determined 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. Reviewed the Daily Revenue Reports and noted any unusual activity. Performed testing of areas identified.
- 3. Selected 3 months for detail testing (March, April, and May 2009). For each month selected, performed the following:
  - a. Obtained monthly revenue report and performed the following:
  - b. Determined Hudson Group was contributing 0.75% of monthly gross revenues to the Joint Marketing Fund as of the Commencement Date of January 31, 2009.
  - c. Verified the Authority was maintaining the Joint Marketing Fund in a separate account and commingled with other funds.
- 4. Determined Hudson Group had not met the initial capital improvement costs and did not submit certified receipts and lien release for the capital improvements to the Authority timely.
- 5. Determined Hudson Group did not meet operational requirements.
  - a. Determined through observations that Concessionaire's premises was maintained in a First Class Manner.
  - b. Verified Concessionaire met operational hours and staffing requirements.
  - c. Determined Concessionaire's employees were trained to respond to airport customer's request for information.
  - d. Determined Concessionaire was not submitting a quarterly update regarding recent trends or developments in airport news, gifts and specialty retail concession operations.
  - e. Verified Concessionaire was not conducting formal performance audits on a bi-monthly basis.
  - f. Determined Hudson Group was not meeting annual reporting requirements.
    - i. Determined Concessionaire was submitting an annual pricing report to ensure reasonable pricing was being maintained.
- 6. Verified Authority personnel were conducting monthly meetings with Concessionaire to discuss operational issues.
- 7. Verified Concessionaire has not met the Disadvantaged Business Enterprise ("DBE") Program requirements established in the contract.
- 8. Determined Hudson Group maintained adequate insurance coverage.
  - a. Obtained a copy of the current certificate of insurance on file.
  - b. Verified that the commercial general liability, property, automobile, and worker's compensation insurance coverage met or exceeded the amounts specified in the contract.

- c. Verified that the certificate of insurance was current and adhered to all other contract terms.
9. Determined Hudson Group maintained an Irrevocable Letter of Credit (“LOC”).
  - a. Obtained a copy of the current LOC.
  - b. Verified that the LOC coverage met or exceeded the amount specified in the contract.
  - c. Verified that the LOC was current and adhered to all other contract terms.
10. Determined Concessionaire’s Sublease tenant met contract requirements.
11. Through inquiry and observation, reviewed the existing internal controls in place.

## **Conclusion**

Based upon the audit, the following were determined with respect to the stated objectives:

1. Hudson Group is not properly reporting the gross revenues from the Concession Operations in the AB-3/6 rotunda as noted in finding #1.
2. Hudson Group had an overpayment of rent to the Authority as noted in finding #2.
3. Hudson Group did not furnish the required annual audited statements to the Authority on a timely basis as noted in finding #3.
4. The annual report provided by Hudson Group did not include the required reconciliation of MAG and payment to the Authority as noted in finding #4.
5. Hudson Group did not provide the required initial capital improvements documentations as noted in finding #5.
6. Hudson Group did not meet the required initial capital improvements amount for certain concession locations as noted in finding #6.
7. Hudson Group is not submitting a quarterly update regarding recent trends or developments in Airport news, gifts and specialty retail concession operations to the Authority as noted in finding #7.
8. Hudson Group is not conducting formal performance audits on a bi-monthly basis as noted in finding #8.
9. Hudson Group is not meeting the annual reporting requirements as noted in finding #9.

## **Finding #1**

### **Observation**

Hudson Group is not properly reporting the gross revenues from the Concession Operations in the AB-3/6 rotunda.

### **Background**

The Hudson Group stores located in the AB-3/6 rotunda should be reported as three (3) separate concepts.

Article V, Financial Terms, Section 5.1 of the Master Lease and Concession Agreement, Periodic Rent, states that for the right to develop, manage and operate the Concession Program as described herein and to lease the Premises in the Terminal during the Term, Concessionaire shall pay, commencing on the first day of the Interim Period and continuing throughout the Term, Periodic Rent determined as follows:

- a. During each year of the Interim and Operational Phase and, Concessionaire shall pay Periodic Rent in an amount equal to the greater of (i) the MAG due for such year as set forth herein or (ii) an amount equal to the applicable percentage of gross revenues from Concession Operations for such year from each Concession Location as set forth below:
  - i. Thirteen percent (13%) of gross revenues derived from News & Conveniences Concession Operations;
  - ii. Fifteen percent (15%) of gross revenues derived from the sale of Nashville Souvenirs Concession Operations;
  - iii. Eleven percent (11%) of gross revenues derived from Bookstore & News Concession Operations; and
  - iv. Twelve percent (12%) of gross revenues derived from the sale of Specialty Retail Concession Operations.

Periodic Rent for any partial year of the Interim and Operational Phase shall be prorated on the basis of actual number of days included in such partial year.

According to the Agreement, the stores in the AB rotunda include the following distinct concept that should be reported separately with the applicable percentage of gross revenues:

<u>Concession Concepts</u>	<u>Concession Operations</u>	<u>% of Gross Revenues</u>
News & Conveniences	Hudson News	13%
Nashville Souvenirs	Nashville Kitchen	15%
Bookstore & News	Hudson Booksellers	11%

Through audit testing it was determined that from the inception of these locations, the stores in the AB rotunda were reported as a Specialty Retail Concession Operation at 12%. Currently, it cannot be determined if any additional funds are due the Authority until the revised annual report is provided by Hudson Group to the Authority.

Recommendation

The Authority’s Properties Department (“Properties”) should require Hudson Group to provide the Authority revised annual report restating the gross revenues of the stores in the AB rotunda into three (3) distinct concepts.

In addition, Properties should require Hudson Group to provide detailed break out of gross revenues from the three (3) concepts in the monthly reporting to the Authority.

Management Response

*Properties will request Hudson Group to provide the Authority a revised annual report restating the gross revenues of the stores in the AB rotunda into three (3) distinct concepts as well as provide a detailed break out of gross revenues from the three (3) concepts in the monthly reporting to the Authority henceforth.*

**Finding #2**

Observation

Hudson Group had an overpayment of rent to the Authority as noted in finding #2.

Background

An objective of this audit was to determine the validity of gross revenues amounts reported and fees paid to the Authority.

In accordance with the terms of the Master Lease and Concession Agreement, Hudson Group will pay to the Authority the greater of a minimum annual guarantee or the news, gifts and specialty retail business and percentage of gross revenues. The following are the gross revenues and percentage payment provisions for Hudson Group per the Statement of Gross Revenues for the Period Ended January 30, 2009, provided by Marcum LLP:

<u>Period</u>	<u>News &amp; Conveniences</u>	<u>Nashville Souvenirs</u>	<u>Bookstore &amp; News</u>	<u>Special Retail</u>	<u>DBE Subtenant</u>	<u>Subtenant</u>	<u>Total</u>
July 2008	\$477,031	\$39,074	\$441,479	\$371,496	\$1,174	\$110,947	\$1,441,200
August	326,875	60,732	394,493	446,839	992	116,104	1,346,035
September	279,448	72,350	345,772	374,389	854	133,471	1,206,284
October	313,686	81,349	390,565	406,264	907	127,400	1,320,172
November	284,858	68,750	349,028	358,096	769	115,660	1,177,162
December	303,471	63,891	350,747	307,074	685	116,197	1,142,065
January 2009	231,209	46,357	305,452	268,343	843	85,349	937,553
Total Gross Revenue	2,216,579	432,502	2,577,536	2,532,501	6,223	805,129	8,570,470
Contractual Percentage							
Rate	13%	15%	11%	12%	4%	12%	
Payment Due	\$288,155	\$64,875	\$283,529	\$303,900	\$249	\$96,615	\$1,037,324
Minimum Annual Guarantee							\$339,932
Rent paid by Hudson Group							\$1,043,204
(Under)/Overpayment							\$5,880

Hudson Group’s percentage payments from the gross revenues were \$1,037,324. Thus, the percentage payment to the Authority was greater than the minimum annual guarantee. The total rent paid by Hudson Group to the Authority for the Period Ended January 30, 2009, was \$1,043,204; therefore Hudson Group had an overpayment of rent to the Authority in the amount of \$5,880. Accordingly, Hudson Group was due a refund for the overpayment of rent to the Authority in the amount of \$5,880, which should be credited to Hudson Group’s account and

applied against one or more of the next succeeding monthly payments during the next ensuing contract year.

### Recommendation

Since the gross revenues of the stores in the AB rotunda needs to be restated, Properties should require The Authority's Finance Department ("Finance") to recalculate Hudson Group's percentage payments to determine if the refund is still due to the Hudson Group.

### Management Response

*Properties will request Finance to recalculate Hudson Group's percentage payments to determine if a refund is due to the Hudson Group.*

## **Finding #3**

### Observation

Hudson Group did not furnish the required annual audited statements to the Authority on a timely basis.

### Background

An objective of this audit was to determine compliance with Agreement terms which requires Concessionaire to furnish Authority with audited statements of gross revenues derived from Concession Program certified by an independent public accounting firm.

Article XIII, Books, Records, Record Keeping and Reports, Section 13.1 of the Master Lease and Concession Agreement, General Requirements, states that Concessionaire shall prepare monthly, quarterly and annual reports of gross revenues derived from the Concession Program and separately listing gross revenues by Concession Operator, Concession Location and type of Concession Operations, using a form and method as directed by Authority, which reports shall be simultaneously delivered to Authority. Annually, within ninety (90) days after the end of each year of the Interim Phase and each Lease Year, Concessionaire shall furnish Authority with audited statements of gross revenues derived from the Concession Program certified to by an independent public accounting firm. Upon Authority's written request, Concessionaire shall make available, and shall cause all Concession Operators to make available, within seven (7) days after a request therefor, to Authority or its authorized representative(s) any and all reports, books, records and accounts, including, without limitation, electronic data, pertaining to the Concession Program necessary to conduct an audit of the Concession Operations of Concessionaire and Concession Operators.

The annual report was provided to the Authority by Hudson Group on April 28, 2010, which was approximately twelve (12) months past the time frame required to provide the report. It should be noted that the required annual audited statements was due to the Authority by April

30, 2009; however the annual report was not requested from Hudson Group until January 12, 2010.

### Recommendation

Properties should review its current procedure and revise as necessary to ensure that annual audited statements required by the Master Lease and Concession Agreement are prepared and furnished to the Authority on a timely basis.

### Management Response

*Properties Lease Management System has been revised to capture this requirement. Properties sent letter requesting this statement 1/12/2010. Phone calls and e-mails followed. Hudson Group submitted requested documents 6/10/2010. A letter requesting Hudson Group to submit this statement for the current period 7/1/2009 through 6/30/2010 representing their first full operational year is forthcoming.*

## **Finding #4**

### Observation

The annual report provided by Hudson Group did not include the required reconciliation of MAG and payment to the Authority.

### Background

An objective of this audit was to determine compliance with Agreement terms which requires the annual report to include specific information to determine if the Concessionaire had underpayment or overpayment of rent to the Authority.

Article V, Financial Terms, Section 5.1 of the Master Lease and Concession Agreement, Periodic Rent, states that within sixty (60) days after the end of each year Concessionaire shall provide its 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 year or Lease Year and the percentage of gross revenues due to Authority for such year or Lease Year to determine the total amount owed to Authority by Concessionaire for such preceding year or Lease Year; and (B) payment of any additional amount owed as Rent for such preceding year or Lease Year under the terms of this Agreement.

The annual report provided by Hudson Group did not include the following required MAG reconciliation and payment to Authority.

- A. A comparison of the MAG for such preceding year or Lease Year and the percentage of gross revenues due to Authority for such year or Lease Year to determine the total amount owed to Authority by Concessionaire for such preceding year or Lease Year; and
- B. Payment of any additional amount owed as Rent for such preceding year or Lease Year under the terms of this Agreement.

As noted earlier, it cannot be determined if any additional funds are due the Authority until the revised annual report is provided by Hudson Group to the Authority.

### Recommendation

Properties should advise Hudson Group of the acceptable annual reporting format. In addition, future annual reporting provided by Hudson Group should comply with this format.

### Management Response

*Properties will advise Hudson Group in writing of the acceptable annual reporting format.*

## **Finding #5**

### Observation

Hudson Group did not provide the required initial capital improvements documentation.

### Background

An objective of this audit was to determine compliance with Agreement terms which requires Concessionaire to meet the initial capital improvement costs and submittal of certified receipts and lien release for the capital improvements to the Authority.

Article X, Construction; Capital Improvement, Section 10.4 of the Master Lease and Concession Agreement, Certification of Construction Expenditures, states that Concessionaire shall provide Authority with certified receipts and lien releases for the Initial Capital Improvements and Midterm Renovations to a concession location required hereunder within ninety (90) days after the completion thereof in detail acceptable to Authority to enable Authority to verify compliance with the requirements of this Agreement. In the event that such certified receipts indicate that Eligible Costs incurred with respect to the Initial Capital Improvements or Midterm Renovations required hereunder are less than required under the terms and provisions of this Agreement, Concessionaire shall pay to Authority one hundred ten percent (110%) of the difference between the amount required to be spent and the Eligible Costs actually incurred by Concessionaire and/or a Concession Operator as indicated by such certified receipts.

Hudson Group did not submit to the Authority the required certified receipts within ninety (90) days after completing of the improvements for the Authority to verify compliance with the requirements of the Agreement. The certified receipts were not submitted until March 3, 2010, which is outside the time frame required to provide the receipts. It should be noted that the required certified receipts were due to the Authority by June 30, 2009; however the certified receipts were not requested from Hudson Group until December 2009.

## Recommendation

Properties should review its current procedures and revise as necessary to ensure that the requirement of the Master Lease and Concession Agreement is adhered to and required documentations are requested and obtained in a timely manner.

## Management Response

*Properties sent letter requesting this documentation 9/24/2008 for those locations that had been completed and were operational at that time. Included in that letter were the remaining News, Gifts, & Specialty (“NG&S”) locations and corresponding due dates for the documentation to be submitted in accordance with contract requirements. Numerous phone calls and e-mails followed. On February 11, 2010, Hudson Group submitted a letter certifying the capital expenditures however it did not follow the required format and was rejected. Hudson Group submitted the appropriate documents on 6/10/2010.*

## **Finding #6**

### Observation

Hudson Group did not meet the required initial capital improvements amount for certain concession locations.

### Background

An objective of this audit was to determine compliance with Agreement terms which requires Concessionaire to expend an amount not less than Three Hundred Sixty Eight and 00/100 Dollars (\$368.00) in eligible cost per square foot for certain concession locations and not less than Four Hundred Dollars (\$400.00) in eligible costs per square foot for the remaining concession locations.

Article X, Construction; Capital Improvement, Section 10.2 of the Master Lease and Concession Agreement, Initial Capital Improvements, states that Concessionaire shall construct, equip and install, or cause to be constructed, equipped, and installed, the Initial Capital Improvements in each Concession Location in accordance with the plans and specifications to be submitted to and approved by Authority in its sole discretion, free and clear of all liens, encumbrances and security interests. The construction, equipping and installation of the Initial Capital Improvements within a Concession Location shall be completed within ninety (90) days after the Turnover Date for such Concession Location. Concessionaire shall ensure that construction activities are closed off from public view with a painted gypsum board dust partition with attractive, easily readable signs explaining the construction, as approved by Authority prior to such construction. The Initial Capital Improvements to be constructed, equipped and installed in concession locations B-5, C-15, PS-2, C-1, AB-6, B-3 and C-4 shall require an expenditure by Concessionaire and/or the applicable Concession Operator of not less than Three Hundred Sixty Eight Dollars (\$368.00) in Eligible Costs per square foot of such concession location. The Initial Capital Improvements to be constructed, equipped and installed in concession locations A-3, C-2, C-13, PS-7, AB-3, B-4, C-9, and C-10 shall require an expenditure by Concessionaire and/or the applicable Concession

Operator of not less than Four Hundred Dollars (\$400.00) in Eligible Costs per square foot of such Concession Location.

In addition, Section 10.4 of the Master Lease and Concession Agreement, Certificate of Construction Expenditures, states that Concessionaire shall provide Authority with certified receipts and lien releases for the Initial Capital Improvements and Midterm Renovations to a Concession Location required hereunder within ninety (90) days after the completion thereof in detail acceptable to Authority to enable Authority to verify compliance with the requirements of this Agreement. In the event that such certified receipts indicate that Eligible Costs incurred with respect to the Initial Capital Improvements or Midterm Renovations required hereunder are less than required under the terms and provisions of this Agreement, Concessionaire shall pay to Authority one hundred ten percent (110%) of the difference between the amount required to be spent and the Eligible Costs actually incurred by Concessionaire and/or a Concession Operator as indicated by such certified receipts. If Authority disputes the amount of Eligible Costs claimed by Concessionaire and/or a Concession Operator, Authority may utilize its own audit and accounting staff or, at its option and expense, hire a certified public accountant to audit the Eligible Costs actually incurred by Concessionaire and/or a Concession Operator with respect to such Concession Location. If it is determined that the Eligible Costs actually incurred by Concessionaire and/or a Concession Operator with respect to such Concession Location are less than the minimum required hereunder, then Concessionaire shall pay, in addition to the other amounts due hereunder, the cost of conducting such audit to Authority within thirty (30) days of the determination.

Through audit testing it was determined that the Hudson Group expended an amount less than the Agreement required amount in eligible cost per square foot for certain concession locations. The following is an analysis of the amount expended by Hudson Group for certain concession locations.

Concession Operations	Concession Location	Concession Concept	Agreement Required Amount Per Square Foot	Store Location Square Feet	Calculated Required Expenditure	Actual (Submitted) Expenditure	Amount Over/(Under) Required Amount	Actual Expenditure per Square Foot	Amount Over/(Under) Required Amount per Square Foot	110% of Under Spent Amount
Sunglass Hut	C-4	Specialty Retail	\$368.00	642	\$236,256.00	\$267,741.44	\$31,485.44	\$417.04	(\$49.04)	
Spirit of the Red Horse	C-4	Specialty Retail	\$368.00	846	\$311,328.00	\$187,353.24	(\$123,974.76)	\$221.46	\$146.54	
Radio Road	C-4	Specialty Retail	\$368.00	1,218	\$448,224.00	\$243,099.98	(\$205,124.02)	\$199.59	\$168.41	
		Total C-4 Location			<u>\$995,808.00</u>	<u>\$698,194.66</u>	<u>(\$297,613.34)</u>			<u>(\$327,374.67)</u>
Kids Works	C-9	Specialty Retail	\$400.00	1,479	\$591,600.00	\$512,221.15	(\$79,378.85)	\$346.33	\$53.67	(\$87,316.74)
Nashville Kitchen, Bookstore, & News	AB-3/AB-6	Specialty Retail/Bookstore & News	\$368.00/\$400.00	2,622	\$1,032,608.00	\$991,721.42	(\$40,886.58)	\$378.23		(\$44,975.24)
					<u>\$2,620,016.00</u>	<u>\$2,202,137.23</u>	<u>(\$417,878.77)</u>			<u>(\$459,666.65)</u>

### Recommendation

Properties should require Finance to invoice Hudson Group for one hundred ten percent (110%) of the difference between the amount required to be spent and the costs actually incurred by Hudson Group in the amount of \$459,666.65.

## Management Response

*It should be noted that Hudson Group expended approximately Eight Million Dollars for the initial capital improvement, which exceeds the overall capital investment proposed by approximately Eight Hundred Thousand Dollars.*

*Properties staff has recommended that, because Hudson Group exceeded the overall proposed capital expenditures, the funds identified in this finding be spent as additional capital expenditures to improve the Kids Works and CMT Loot locations through remerchandising the former and re-concepting the later.*

## **Finding #7**

### Observation

Hudson Group is not submitting a quarterly update regarding recent trends or developments in Airport news, gifts and specialty retail concession operations to the Authority.

### Background

An objective of this audit was to determine compliance with Agreement terms which requires Concessionaire to submit quarterly update regarding recent trends or developments in Airport news, gifts and specialty retail concession operations to the Authority.

Article IV, Concessionaire's Obligations, Section 4.2k of the Master Lease and Concession Agreement, Concession Management, states that Concessionaire should remain current with all trends in Airport news, gifts and specialty retail concession operations and provide to the Authority a quarterly update regarding recent trends or developments in Airport news, gifts and specialty retail concession operations.

It should be noted that Hudson Group have not provided any quarterly report to the Authority on trends or developments in Airport news, gifts and specialty retail concession operations since the inception of this Agreement.

### Recommendation

Properties should request from Hudson Group recent reports regarding trends and developments in Airport news, gifts and specialty retail concession operations.

On an ongoing basis, Properties should keep track of this and other periodic reporting requirements in the Agreement.

## Management Response

*Properties will request Hudson Group to submit reports regarding trends and developments in N, G & S retail concession operations henceforth. Properties will also trigger dates for periodic report requirements in the Properties Management suspense system.*

## **Finding #8**

### Observation

Hudson Group is not conducting formal performance audits on a bi-monthly basis.

### Background

An objective of this audit was to determine compliance with Agreement terms which requires Concessionaire to conduct formal performance audits on a bi-monthly basis.

Article XXVI, Operational Audits, Section 26.2 of the Master Lease and Concession Agreement, Performance Audits, states that Concessionaire shall conduct formal performance audits for each Concession Location on a bi-monthly basis to ensure that all of the operational, safety and customer service requirements for Concession Operations are consistently met and that patrons of the Airport receive the quality of service required under this Agreement. Authority reserves the right to participate in such audits at its discretion. Concessionaire shall submit the form of the evaluation document to be used in such performance audits to Authority for approval during the Pre-Occupancy Phase, and Authority shall have a minimum of forty-five (45) days to review and approve such evaluation document prior to the Interim Phase.

However, it should be noted that Hudson Group performs an informal review of its operation by the onsite general manager which is not document and thus not provided to the Authority.

### Recommendation

Properties should create a formal performance audit reporting format for the Master Lease and Concession Programs. This format should be provided to Hudson Group and Hudson Group should be required to complete and submit the formal audit to the Authority periodically.

### Management Response

*Properties will create a formal performance audit reporting format for the news, gift and specialty retail concession operators. Once developed, the Authority will require that Hudson Group regularly submit audit reports on a 4-week cycle.*

## **Finding #9**

### Observation

Hudson Group is not meeting the annual reporting requirements.

### Background

An objective of this audit was to determine compliance with Agreement terms which requires Concessionaire to provide Annual Reporting to the Authority by the end of the Lease Year.

Article IV, Concessionaire's Obligations, Section 4.6 of the Master Lease and Concession Agreement, Annual Reporting, states Concessionaire shall submit, within sixty (60) days after the end of each twelve (12) month period or portion thereof during the Interim Phase, and within sixty (60) days after the end of each Lease Year (and at one other time during each Lease Year if desired by Concessionaire or if requested by Authority), a report that shall contain the following:

- a) A review of the performance of Concession Operations for such prior twelve (12) month period, Lease Year or other applicable period, as the case may be, including, without limitation, Concession Operators' achievement of sales projections, financial results and other goals and objectives;
- b) The establishment of new operational goals and objectives for the forthcoming Lease Year, including projections, for each Concession Location, of sales, sales per square foot, sales per Enplaned Passenger and payments to Authority for the forthcoming Lease Year;
- c) Identification of Concession Operations that either will or might be replaced during the forthcoming Lease Year, along with photos, drawings, *etc.*, of proposed replacement concepts and the reasons for such recommended changes;
- d) A discussion of Concession Operators' customer service improvements, initiatives and activities, including, without limitation, information on surveys, secret shopper programs, incentives, *etc.*;
- e) Any planned expenditures or investments for improvements in the Concession Locations;
- f) Any changes or improvements in Concession Operations anticipated in the forthcoming Lease Year, such as marketing efforts, training or services at Concession Locations by Concession Operators;
- g) Copies of any consumer surveys completed by a Concession Operator and other industry trend studies;
- h) A review of customer service issues, a complaint summary and how complaints were handled during such prior twelve (12) month period, Lease Year or other applicable period, as the case may be, with respect to Concession Operations;
- i) An updated listing of Concession Locations, including, without limitation, names, types and square footage of Concession Locations;
- j) A listing of any problems encountered during such prior twelve (12) month period, Lease Year or other applicable period, as the case may be, and/or improvements to operations to enhance customer service, sales or other aspects of Concession Operations that might reasonably be completed by Authority in concert with Concessionaire; and
- k) Any other information reasonably requested by Authority.

It should be noted that items c and i were the only items that were reported to the Authority during FY2009.

#### Recommendation

Properties should request from Hudson Group the required annual reporting.

As previously stated, on an ongoing basis, Properties should keep track of this and other periodic reporting requirements in the Agreement.

## Management Response

*Properties will request from Hudson Group the required annual reporting. This requirement will be better captured in the Properties Lease Management System to ensure compliance with this and other periodic reporting requirements in the Agreement.*