

Audit Follow-Up

As of March 31, 2017



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City Auditor

Audit of Selected Airport Leases

(Report #1620, Issued September 6, 2016)

Report #1709

May 11, 2017

Summary

Six of the 13 action plan steps established to address issues identified in audit report #1620, Audit of Selected Airport Leases, were due for completion as of March 31, 2017. Of the six steps due for completion, one step has been completed, one step was not actionable during this follow-up period, and four steps are in progress. Substantial efforts have been made toward completion of those four steps. We will follow-up on efforts to complete the four action plan steps in progress, as well as the remaining seven action plan steps not yet due for completion, in a subsequent follow-up engagement. We will also follow-up on the one action plan step for which no action could be taken this follow-up period.

In audit report #1620, issued September 6, 2016, we concluded that, overall, the Aviation Department effectively managed leases of City-owned property at the Tallahassee International Airport (Airport) for which the tenants also subleased some or all of the property to other entities, or for which the property was leased for nominal consideration. However, we identified several areas for improvement. Those areas related to establishing an internal leasing policy, tracking and managing leases, leasing property at fair market value, collecting lease revenues, executing nominal value leases, pre-approving

subleases, and maintaining insurance documentation. We determined that Aviation Department management was aware of several of the noted areas prior to the start of our audit, and initiated actions to address those areas. We made several recommendations to further enhance and strengthen the Airport's existing lease practices.

Thirteen action plan steps were developed to address the identified issues. For this first audit follow-up, conducted as of March 31, 2017, six of those 13 action plan steps were due for completion. Our follow-up shows one step was completed, one step was not actionable during this follow-up period, and four steps are in progress. The status of the one action plan step completed during the period covered by this follow-up engagement is as follows:

- The Aviation Department was successful in collecting on Million Air's delinquent account. The lessee is now current with all lease payments.

The one action plan step that was not actionable during this follow-up engagement period consisted of the following:

- No new leases were executed during this follow-up period. As such, the Aviation Department was unable to enter into leases at fair market value for developed property. The Aviation Department anticipates executing at least one new lease during the next follow-up period.

The four action plan steps determined to be in progress but not completed included the following:

- Developing and adopting a formal comprehensive leasing policy that incorporates industry best practices;
- Incorporating provisions in the leasing policy (developed pursuant to the aforementioned step) that address the criteria and circumstances in which Airport property will be leased for nominal consideration;
- Incorporating provisions in the leasing policy (developed pursuant to the aforementioned step) regarding the escalation of lease rates, including the nature and frequency that such escalations should be applied; and
- Incorporating provisions in the leasing policy (developed pursuant to the aforementioned step) that detail the actions that should be taken with regard to collecting amounts for delinquent accounts.

In regard to these four steps that are in progress, we found that substantial efforts have been made by management toward completing the required actions, as a draft policy incorporating the recommended provisions has been prepared and is currently pending review by appropriate levels of City management before finalization and adoption.

In a subsequent follow-up audit, we will follow-up and report on management's efforts to complete the one action plan step that was not actionable during this follow-up period, the four action plan steps determined to be in progress, and the seven action plan steps not yet due for completion.

We appreciate the cooperation and assistance provided by Aviation Department management and staff during this audit follow-up.

Scope, Objectives, and Methodology

We conducted this audit follow-up in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require we plan and perform the audit follow-up to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit follow-up objectives.

Original Report #1620

The scope of the original audit (report #1620) included a review of active leases of City-owned property (land and facilities) at the Airport for which the tenants also subleased some or all of the property to other entities, or for which the leases were executed for nominal consideration. The audit only addressed those leases pertaining to activities outside the main passenger terminal area (i.e., general aviation).

For the addressed leases, the objectives of the audit were to determine whether:

- The Aviation Department maintained proper oversight over the related leasing activities;
- The leasing activities were in the best interest of the City;
- The City was adequately protected from exposure to risk; and
- Lease revenues due the City were reasonable and properly and timely collected.

Report #1709

This is our first follow-up on action plan steps identified in audit report #1620. The purpose of this audit follow-up is to report on the progress and status of efforts by the Aviation Department to complete action plan steps due for completion as of March 31, 2017. To determine the status of these action plan steps, we interviewed applicable staff and obtained and reviewed relevant documents.

Background

At the time of the initial audit, the City of Tallahassee (City) leased space to 53 entities at the Airport. The City leased both terminal and non-terminal property to a variety of entities including commercial airlines, cargo companies, rental car agencies, concessionaires, the federal government, and general aviation service providers. The Aviation Department’s Finance and Administration Division provided for the financial management of the leases while the Commercial Development Division was responsible for the negotiation of leases and the day-to-day administration of the Airport’s commercial tenants (e.g., lease development, tenant relations, and compliance monitoring).

Our audit included a review of the leasing activity related to general aviation and cargo services (i.e., all leases with airport tenants outside the

passenger terminal area that also sublease property to another entity). With regard to those general aviation leases executed between the Aviation Department and commercial entities, there were, at the time of our audit, 12 active leases with five of those 12 leases including subleases. Regarding cargo services, there was, at the time of our audit, one active lease involving a sublease.

Our review also addressed leases executed by the Aviation Department for nominal consideration. Three of the Airport general aviation leases are nominal value leases where the lessees pay nothing or amounts that are significantly less than market value.

Previous Conditions and Current Status

In report #1620, we identified areas for improvement to enhance and strengthen existing leasing practices at the Airport. Aviation Department management developed 13 action plan steps to address the identified issues and recommendations. Six of those 13 action plan steps were due for completion no later than March 31, 2017. As shown in Table 1 that follows, as of that date, one of the six steps has been completed, one of the steps was not actionable during the follow-up period, and four of the steps are in progress.

Table 1
Action Plan Steps from Audit Report #1620
Current Status as of March 31, 2017

Action Plan Steps Due	Current Status as of March 31, 2017
<p><i>Objective: Ensure the Aviation Department maintains proper oversight over the Airport’s leasing activities.</i></p>	
<ul style="list-style-type: none"> • A formal comprehensive leasing policy that incorporates best practices will be developed and adopted. 	<ul style="list-style-type: none"> ○ <u>In Progress</u> – As of the end of this follow-up period, the Aviation Department has not finalized and adopted a formal leasing policy. The department has, however, substantially completed such a policy (<i>Departmental Procedures for Airport Leasing</i>). The policy, currently in draft form, is pending reviews by the Director of Aviation, the City Attorney’s Office, the City Treasurer-Clerk’s Risk Management Division, and the Real Estate Management Department. Aviation Department management reported they plan to finalize the policy by May 31, 2017. We will address management’s remaining efforts to complete and adopt the policy in our subsequent follow-up engagement.
<p><i>Objective: Ensure the Airport’s leasing activities are in the best interest of the City.</i></p>	
<ul style="list-style-type: none"> • If and/or when new leases are executed upon the expiration of current leases of Airport properties that were developed by the lessees, those new leases will be executed at fair market value for developed property when appropriate. 	<ul style="list-style-type: none"> ❖ <u>No Action Could Be Taken</u> – The Aviation Department has not executed any new leases since our initial audit. Therefore, this step was not actionable for this first audit follow-up. The Aviation Department, however, anticipates executing at least one new lease during the period to be covered by our next follow-up. We will address the status of this action plan step in our subsequent follow-up engagement.
<ul style="list-style-type: none"> • The formal comprehensive leasing policy will provide the criteria and circumstances in which Airport property will be leased for nominal consideration. 	<ul style="list-style-type: none"> ○ <u>In Progress</u> – As previously disclosed, the Aviation Department has made substantial progress on the development of a formal Airport leasing policy. Our review of the leasing policy <u>draft</u> shows the Aviation Department appropriately addressed nominal leases and included provisions in accordance with applicable recommendations made in our original audit report. Notwithstanding that the <i>Departmental Procedures for Airport Leasing</i> are substantially complete, our definitive determination regarding provisions contained

	<p>therein will be made subsequent to the formal adoption of the policy. As stated previously, management now plans to finalize the policy by May 31, 2017. We will address the status of this action plan step in a subsequent follow-up engagement.</p>
<p><i>Objective: Ensure lease revenues are reasonable and properly and timely collected by the Aviation Department.</i></p>	
<ul style="list-style-type: none"> • The formal comprehensive leasing policy will include appropriate provisions regarding escalation of lease rates, including the nature and frequency that such escalations should be applied. 	<ul style="list-style-type: none"> ○ <u>In Progress</u> – As previously disclosed, the Aviation Department has made substantial progress on the development of a formal Airport leasing policy. Our review of the leasing policy <u>draft</u> shows the Aviation Department appropriately addressed escalation of lease rates and included provisions in accordance with applicable recommendations made in our original audit report. Notwithstanding that the <i>Departmental Procedures for Airport Leasing</i> are substantially complete, our definitive determination regarding provisions contained therein will be made subsequent to the formal adoption of the policy. As stated previously, management now plans to finalize the policy by May 31, 2017. We will address the status of this action plan step in a subsequent follow-up engagement.
<ul style="list-style-type: none"> • Efforts will be continued to collect on Million Air’s delinquent account. 	<ul style="list-style-type: none"> ✓ <u>Complete</u> – As of the time of this follow-up engagement, Million Air is current in making lease payments to the City. The lessee is no longer in delinquent account status. We commend the efforts made by staff in the Aviation Department, particularly in the Finance and Administration Division, to collect the amounts owed on the delinquent account.
<ul style="list-style-type: none"> • The formal comprehensive leasing policy will include appropriate actions that should be taken in regard to collecting amounts for delinquent accounts. 	<ul style="list-style-type: none"> ○ <u>In Progress</u> – As previously disclosed, the Aviation Department has made substantial progress on the development of a formal Airport leasing policy. Our review of the leasing policy <u>draft</u> shows the Aviation Department appropriately addressed the treatment of delinquent accounts and included provisions in accordance with applicable recommendations made in our original audit report. Notwithstanding that the <i>Departmental</i>

	<p><i>Procedures for Airport Leasing</i> are substantially complete, our definitive determination regarding provisions contained therein will be made subsequent to the formal adoption of the policy. As stated previously, management now plans to finalize the policy by May 31, 2017. We will address the status of this action plan step in a subsequent follow-up engagement.</p>
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Table legend

- Issue to be addressed from original audit.
- ✓ Actions to address the issue have been completed.
- Actions to address the issue are in progress.
- ❖ No action could be taken for this follow-up period.

Conclusion

Of the 13 total action plan steps established to address issues identified in the original audit, six steps were due for completion as of March 31, 2017, and were therefore addressed in this first audit follow-up. As shown in Table 1 above, one of those six steps has been successfully completed, one step was not actionable this follow-up period, and the four remaining steps are in progress with plans to be completed in the near future.

The seven remaining steps not yet due for completion, which will be addressed in a subsequent follow-up engagement, pertain to:

- The Aviation Department’s implementation of a consolidated lease management system.
- Determinations as to whether certain properties currently subleased by lessees should, instead, be leased directly by the Aviation Department.
- For future leases of airport properties for nominal rates, including the rationale and justifications for those nominal rates within the executed lease documents.

- Ensuring appropriate escalation provisions are included in future lease agreements when applicable.
- Ensuring the City is adequately protected from exposure to risk through timely pre-approval of subleases, completion of Airport Use Agreements when applicable, enhanced tracking of required insurance coverages, and ensuring timely exchange of insurance-related documentation between the Aviation Department and the Treasurer-Clerk’s Risk Management Division (*three steps*).

We will follow-up on the status of the five action plan steps not completed as part of this follow-up, as well as the seven action plan steps not yet due for completion, in a subsequent follow-up engagement.

We appreciate the cooperation and assistance provided by Aviation Department management and staff during this follow-up engagement.

Appointed Official's Response

City Manager:

I would like to thank the City Auditor and his staff for their thorough review of the management of leases at the Tallahassee International Airport. I am pleased to see that progress has been made toward completing action items that will improve the existing leasing practices. I appreciate the City Auditor and Aviation Department staff for their commitment to ensuring best practices are followed in the administration of Airport leases and subleases.

Copies of this Follow-Up Audit Report #1709 or the initial audit report #1620 may be obtained from the City Auditor's website (<http://www.talgov.com/transparency/auditing-auditreports.aspx>), via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

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