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Hangar Leases Audit

June 30, 2017



**City of Fort Worth
Department of Internal Audit**

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The Hangar Leases Audit was conducted as part of the Department of Internal Audit's Fiscal Year 2017 Annual Audit Plan.

Audit Objectives

The objective of this audit was to ensure compliance with lease agreement terms and conditions.

Audit Scope

Our audit covered hangar leases at Meacham and Spinks airports for the period from October 1, 2014 through September 30, 2016.

Opportunities for Improvement

Review leases to identify rate changes scheduled for future dates, then use a software solution to aid in tracking

Document annual Consumer Price Index-based lease rate changes annually

Replace or improve the Lease Management Software

Ensure that a lease contract is filed for all tenants

Document the process for adjusting lease accounts and ensure management review

Verify annual receipt of updated insurance certificates

Executive Summary

As part of the Fiscal Year 2017 Annual Audit Plan, the Department of Internal Audit conducted an audit to evaluate compliance with airport hangar lease agreement terms and conditions. The Aviation Department manages hangar leases at Meacham and Spinks Airports.

While we found that the majority of leases were billed at the correct rates, we identified four (4) leases out of a sample of 55 tested (7.3%) that were not billed correctly. We identified net lease undercharges of \$40,975 from a sample of accounts tested that were billed \$1.7 million during the two-year audit period. In addition, documentation to support the rate increase effective October 1, 2014 was not available in Aviation Department files.

We found that the Lease Management System (LMS) software used to manage lease billing and payment transactions has control deficiencies, including gaps in system records. The system also lacks a date reminder feature that would be helpful for effective lease management. Documentation supported 27 calls to the Information Technology Solutions (ITS) Department Help Desk for software support in September 2016.

A lease contract could not be located in the Aviation Department or City Secretary files to document the existence of an authorized lease with one tenant of a community hangar space at Spinks Airport for approximately 22 months of the 24-month audit period. However, the tenant made payments at the standard rate for a community hangar. Based on a review of tenant files, approximately 38% of Aviation Department lessee files did not have insurance certificate documentation to support compliance with contract insurance terms.

We found that the Aviation Department did not have procedures that require management approval of account adjustments and that the LMS security access settings did not prevent employees who processed payments from also processing adjustments. Adjustments to remove late fees and correct errors totaled \$52,728 in FY2015 and \$21,241 in FY2016. However, we did not conclude that any of the adjustments were inappropriate, as they were a result of repeated mail delays due to the temporary relocation of Aviation offices and error corrections.

A returned check receivable balance of \$5,850 (in the Municipal Airport Fund), resulting from three returned checks, has remained unchanged since FY2009. Also, there is no offsetting allowance account within the Municipal Airport Fund for the receivable. These audit findings are discussed in further detail within the [Detailed Audit Findings](#) section of this report.

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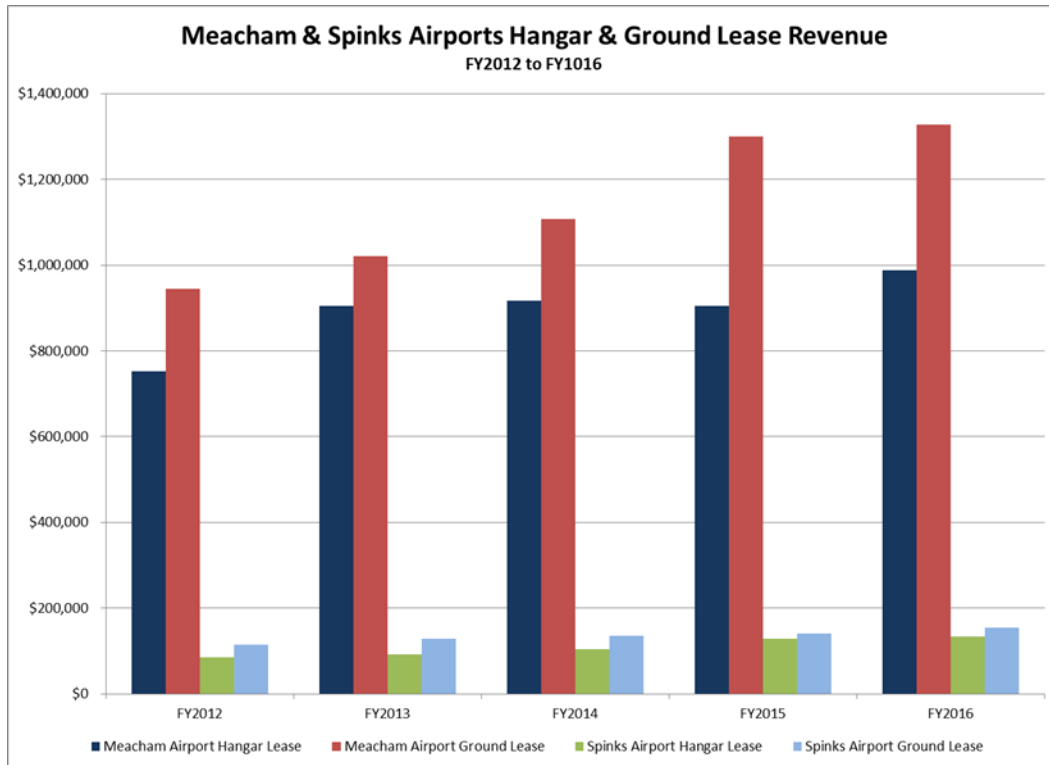
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Background

The Aviation Department managed approximately 125 lease accounts at Meacham International Airport and Spinks Airport during FY2015 and FY2016. Each account holder may lease multiple hangars under different contracts.

Total lease revenue recorded in the Municipal Airport Fund has increased every year for the previous five years. Meacham Airport generates approximately eight times more hangar and ground lease revenue than Spinks Airport, annually.



Source: City of Fort Worth General Ledger

Leased Property

Hangar lease accounts may include a community hangar, a single hangar, multiple hangars, and/or a ground lease. Council approval is required for all leases other than month-to-month community and T-Hangar leases.

- Community or T-Hangars – an assigned space within a hangar shared with others
- Hangar and Ground Leases – includes a hangar building and ground lease component that have different rates, with some tenants leasing multiple hangars under one or more leases
- Ground Only Leases – typically require a tenant to build a hangar on the property under a long term lease, with the hangar ownership passing to the City when the lease term expires

Lease contracts may have a month-to-month term for community and T-hangars, or up to a 40-year term for larger hangars. Community and T-Hangars are in high demand with a waiting list for available spaces. The longer term contracts typically include requirements to build a hangar or substantially



improve a property that will be owned by the airport when the lease term is completed. The longer term allows the tenant to recover the cost of improvements or new construction.

A tenant may have a single contract or multiple contracts for several properties. A lease may include assigned leases that were transferred by other tenants with the City's approval.

Lease Rates

Lease rates may be based on several factors including:

- published rates approved by the Council;
- rates specified by a contract;
- a combination of published and contract rates; and/or,
- an external appraisal to determine the market rate for similar hangars.

Rates for community hangars, T-Hangars, ground leases, and other services are compared annually to other local airport rates to determine if market rate adjustments are needed.

For lease rates established by contract terms, the agreements vary, but there are typically clauses that specify rate increases over the term of the lease based on:

- increases in the Consumer Price Index (CPI) for the Fort Worth Dallas area, as published by the US Department of Labor;
- increases at specified five-year intervals to the published ground lease rate; and,
- increases at specified ten-year intervals to an appraised market hangar lease rate.

Lease contracts may specify rate changes on October 1 each year, but changes specified at other dates were identified in contract terms including two June 1 rate changes. As a result of the multiple possible rate change factors, lease contracts must be analyzed carefully to determine the correct rate based on the CPI change and interval based rate increases.

Lease Billing

Lease billings are processed monthly on the 15th day of each month (or the next working day) for the next month's rent, using the internally-developed Lease Management System (LMS) software. Bills are mailed to tenants. Payments are due on the first day of the month and considered past due if not paid by the 10th day of the following month, after which, a late fee of 10% of the outstanding balance is applied.

Lease Payment Processing

Lease payments are processed by Aviation Department personnel using the LMS system. Leases may be paid using checks or credit/debit card. Card customers may enroll in a recurring payment program that does not require mailing a payment each month.

Insurance Requirements

Lease contracts have liability insurance requirements to protect the City from potential losses. The insurance requirements vary depending on the type of business or operations conducted by the tenant.



Objectives

The objective of this audit was to ensure compliance with lease agreement terms and conditions.

Scope

Our audit covered the period from October 1, 2014 to September 30, 2016. CPI changes for prior years were reviewed to analyze current rates that depend on cumulative CPI increases over multiple years.

Alliance Airport leases managed by Alliance Air Services were not within the scope of this audit.

Methodology

To achieve the audit objectives, the Department of Internal Audit performed the following:

- interviewed key personnel within the Aviation Department regarding lease management and the LMS software;
- reviewed lease contract files retained by the City Secretary's Office and the Department of Aviation;
- reviewed published rate documents for each year during the audit period;
- reviewed insurance certificates in Department of Aviation files to verify compliance with insurance requirements;
- reviewed hangar lease billing and payment transactions in the LMS system and interfaced general ledger (GL) transactions;
- compared hangars on airport maps to LMS billings to search for any properties that were vacant and not billed;
- conducted site visits to verify that properties without payments in the LMS were vacant;
- contacted personnel within the Information Technology Solutions (ITS) Department regarding the LMS software; and,
- evaluated internal controls related to airport hangar lease operations.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



Audit Results

Department of Aviation personnel generally billed and processed lease payments accurately with the following exceptions noted.

Lease Billing

While the majority of lease billings tested were correct, errors in billed amounts were identified for four (4) of the 55 accounts tested (7.3%) from the population of 125 accounts with payments during the audit period. The net under billing error for the two-year audit period was \$40,975, which represents approximately 2.4% of the \$1.7 million of revenue billed for the tested accounts.

LMS Software Deficiencies

The LMS software had 24 missing or deleted invoice transaction records and two missing or deleted payment transaction records that delete the system audit trail for those records. The system lacks features such as a date reminder that could reduce billing errors. Inaccurate bills are occasionally generated that require assistance from ITS personnel to correct. Also, the LMS to GL interface process requires a manual journal entry to balance the accounts.

Missing Lease Contract

Since the lease contract for a community hangar space could not be found in the Aviation Department or in the City Secretary's files, we were unable to verify that there was ever a lease contract for the property. We were, however, able to verify that monthly payments were made by the occupant.

Lease Payment and Adjustment Processing

Only checks or credit/debit cards are accepted for payment with an autopay option for card payments. The Aviation Department does not have written procedures for processing account adjustments that result in credits to customer accounts, and the current verbal adjustment policy does not require management approval. LMS access settings permit employees who process payments to also process adjustments, which is an internal control weakness. No adjustments were processed by the employees who processed a majority of the payments during the audit period.

Returned Check Receivable

The Municipal Airport Fund includes a returned check receivable account with a balance of \$5,850 that has remained unchanged since FY2009. The balance resulted from three checks, received from former tenants that were returned in FY2009. Information regarding the disposition of the three checks was not available, and there is no offsetting allowance account for the receivable.

Insurance Requirements

Insurance certificates were not available to support compliance with insurance terms of leases for approximately 38% of the leaseholder account files reviewed. Documents were available to support coverage for the other 62% of lease accounts, but the coverage did not match requirements for all accounts. The Aviation Department policy requires that lessees maintain automobile liability coverage, but files did not include documents supporting automobile liability coverage for the majority of accounts.



Overall Evaluation

High	Medium	Low
Lease account billing errors		
LMS Software deficiencies		
Unfiled tenants contracts		
Weak account adjustment process controls		
	Stale returned check receivable balance	
	Insurance documentation not retained	



Detailed Audit Findings

1. Four hangar leases were erroneously billed.

Rates for hangar leases are specified by lease contracts and published rates. Lease contracts typically include annual rate increases based on the CPI changes. Published rates approved by the Council are used for community hangars, T-Hangars, and ground leases when contracts specify published rates.

During our review of hangar leases, four (4) of the 55 (7.3%) accounts tested were charged rates that varied from the contract rate for at least one month during the two-year audit period. For two accounts, rate increases were not implemented as specified by contracts. The rate variances resulted in net lease undercharges of \$40,975 representing approximately 2.4% of the \$1.7 million billed for the sample of 55 accounts tested.

As noted in the [Background](#) section of this report, lease contracts typically specify rate changes on October 1 of each year. However, the increase for October 1, 2014, varied from the CPI change published for that year and no documentation was available to support the variance. Without documentation to support the adjustment method, we were unable to verify accuracy of the increase. However, subsequent year increases were verified to the US Department of Labor statistics.

Lease contract terms are complex and may specify rate changes on specific future dates or at intervals throughout the term of the lease. A November 2009 consultant's report noted high turnover in Aviation Department personnel, which could affect the number of personnel with knowledge about the terms of individual leases.

Lessees were undercharged by a net \$40,975 during the audit period, resulting in lost revenue to the City and incorrect charges to four tenants. Documentation to support CPI-based rate changes was not retained in all prior years. Turnover in the personnel responsible for rate changes may have contributed to the failure to retain documentation.

Recommendation 1A: *The Aviation Director, in conjunction with the City Attorney, should determine the feasibility of collecting the \$40,975 net underpayment.*

Auditee Response: Do Not Concur. The Aviation Department will not attempt recovery of the underpayment of \$40,975 due to four hangar leases that were erroneously billed. Two of the tenants are no longer lessees on the airport which will make the recovery of the underpayment challenging. This underpayment is due to the inability of the LMS to track rate adjustments as well as staff turnover. The Aviation Department is working to ensure that future software procured will track lease rate adjustments so that rate increase oversights will not occur in the future.

Target Date: Completed

Responsibility: Sr. Administrative Assistant

Recommendation 1B: *The Aviation Director should require that lease contracts be reviewed to identify all terms that require rate changes at specific future dates. A methodology should be implemented to ensure that alerts are received for future rate changes.*



Auditee Response: Concur. All lease contracts will be reviewed and rate changes will be tracked to ensure that rate adjustments are not missed. Rate adjustments are currently being tracked on a spreadsheet; however, a feature will be implemented into LMS that will track and alert when a lease is up for expiration or renewal and when rates are to be adjusted.

Target Date: January 31, 2018

Responsibility: Sr. Administrative Assistant

Recommendation 1C: *The Aviation Director should ensure that documentation is prepared to support future rate changes and that the documentation is retained for the duration of all leases affected by the change.*

Auditee Response: Concur. Department of Labor (DOL) reports are being saved to the Aviation network files to support future consumer price index (CPI) rate adjustments. In addition, any CPI increases that are above and beyond what is published by the DOL will be supported by additional documentation that provides justification for the additional increase.

Target Date: Complete

Responsibility: Sr. Management Analyst

2. The LMS software has deficiencies that hinder effective lease management.

Internal control standards for information systems require audit trails for computer system transactions. Specifications for commercial lease management software include a critical date management feature and other tools. Financial Directive FD02, *Journal Entry and Account Reconciliation* requires departmental reconciliation of subsidiary ledgers which would include reconciling LMS transactions to the GL.

The Aviation LMS deficiencies include:

- gaps in system record numbers indicating that record deletions have occurred;
- the system has no date reminder feature that would provide notification for lease contract changes;
- invoices generated occasionally that have balance errors that require generating a manual invoice;
- an interface process that requires a manual journal entry each month to record receivables in the GL; and,
- interface transactions that are difficult to reconcile to the GL, which has hindered the department's development of a verification process.

The Aviation and ITS Departments have worked to reduce the number of invoices with errors that must be manually corrected with satisfactory results according to both departments.

According to Aviation staff, deleted records resulted when management had to make billing corrections. Additionally, ITS personnel stated that the missing records resulted from a system "feature gap" that limited the ability to correct invoices without deletions. Internal Audit noted that the LMS system design did not include a critical date management tool. As a result, rate changes that are specified by contracts could have been missed resulting in rates not being increased on the correct dates, ultimately resulting in lower revenue. The invoice errors required the creation of manual bills. Additionally, manual journal



entries must be prepared monthly, and additional time is required to reconcile LMS transactions and the GL.

Recommendation 2: *The Aviation Director should consider replacement of the LMS software or implementing significant improvements to the system's controls and features.*

Auditee Response: Concur. Aviation is in the process of procuring new software that will support leasing, maintenance and operations. In the interim, the Aviation Department is working on Phase III enhancements with the IT Department that will correct some of the deficiencies that we are currently experiencing with the LMS software.

Target Date: May 31, 2019

Responsibility: Sr. Administrative Assistant

3. No contract supports the lease agreement between the CFW and one community hangar tenant at Spinks Airport.

City Code Section 2-9 requires a contract for a lease of real property. Contracts should be delivered to the City Secretary, with a copy retained in departmental files for all hangars based on the requirements of the City Code and to protect the interests of both parties. An official copy (the official) should be retained by City Secretary's Office.

A lease contract could not be found by the Aviation Department and was not available in the City Secretary's files for one occupant of a community hangar at Spinks Airport who made the standard community hangar rate payments for 22 months during the audit period. The hangar was vacated in March 2017. We were unable to determine whether the tenant had a contract.

The lack of a formal contract for a real property lease could violate the City Code and any dispute regarding the terms of occupancy could be complicated by the failure to maintain a copy of a contract with the tenant.

Recommendation 3: *The Aviation Director should ensure that lease contracts are executed before tenants occupy airport properties.*

Auditee Response: Concur. The Leasing Coordinator (LC) is responsible for coordinating tenant move-ins, at Spinks, with the Operations Officer and is solely responsible for coordinating tenant move-ins at Meacham. The LC will ensure that lease documents are fully executed prior to tenants occupying airport properties.

Target Date: Completed

Responsibility: Sr. Administrative Assistant



4. The account adjustment process lacks critical controls and is not documented.

Finance Directive, FD20, *Accounts Receivable*, specifies departmental processes for receivable account adjustments along with the separation of duties between payment processing and receivable account adjustments.

While the Aviation Department has written payment processing procedures, there are no written policies or procedures governing the issuing of credit adjustments to lease accounts. In FY2015, credit adjustments of approximately \$52,728 were processed to correct errors and adjust late payment fees charged to customers. Adjustments do not require approval at a level of management above the person processing the adjustment and can be processed by employees who accept payments. It should be noted that we did not identify any inappropriate adjustments as these adjustments were required due to repeated mail delays after the temporary relocation of administration offices and billing error corrections.

Controls over the adjustment process are not consistent with Financial Directive, FD20, *Accounts Receivable*, which increases the risk of financial loss to the City.

Recommendation 4: *The Aviation Director should ensure that the account adjustment process is documented, including a requirement for approval at an appropriate management level based on the amount of the adjustment and a requirement for the separation of the adjustment and payment processing functions.*

Auditee Response: Concur. Accounts Receivable staff (A/R) sends the request for an account adjustment to the LC, who then reviews the request and the account history of the tenant. If an adjustment is needed the Leasing Coordinator signs off on the adjustment print out and submits it to the Administrative Manager (AM) for review. If approved, the AM will also sign off on the adjustment print out and then the adjustment will be processed by the LC. The print out is then provided to AR for filing and reconciliation.

Target Date: Completed

Responsibility: Sr. Administrative Assistant

5. The \$5,850 Accounts Receivable balance, within the Municipal Airport Fund, includes three returned checks from FY2009.

Finance Directive, FD20, *Accounts Receivable*, requires that accounts receivable balances in the GL include a reserve for amounts unlikely to be collected and be written off when no longer collectible.

The Returned Check Receivable account for the Municipal Airport Fund has a balance of \$5,850 that has not changed since FY2009 and is not offset by an allowance account. The returned checks are from three payees who are no longer tenants and were recorded in the GL in FY2009. Records that would document any collection efforts or repayments are no longer available, and there is no reserve account in the Municipal Airport Fund to offset the balance.

Aviation staff indicated that efforts were made to clear the balances around the time the checks were returned, but that staff was unable to do so due to a lack of documentation. The review and write off of uncollectible balances required by FD20, *Accounts Receivable*, has not been performed. It should be noted that the Aviation Department has very few returned checks with none recorded since FY2009.



As a result, the GL includes a \$5,850 balance that is unlikely to be collected and is not offset by an allowance account, which overstates the fund's assets.

Recommendation 5: *The Aviation Director should direct staff to review and request a write off of the FY2009 receivable, if they determine that the amounts are not collectible.*

Auditee Response: Concur. Aviation staff has submitted a request to Finance to write off this balance as it is determined uncollectable. The Finance Department is in the process of writing off the uncollectable receivable.

Target Date: July 14, 2017

Responsibility: Sr. Administrative Assistant

6. Records documenting tenants' compliance with insurance requirements were not available/retained.

The Aviation Department's Leasing Policy and lease contracts include insurance coverage requirements that include naming the City as an additional insured. Insurance requirements include coverage for specific types of potential losses, typically including property damage, general liability and automobile liability.

Insurance certificates or other supporting documents were not available in Aviation Department files for 21 (38%) of the 55 lessee accounts tested to verify compliance with insurance requirements. For lease accounts where the documentation was available, the documented coverage did not match the lease contract requirements in each case. For example, contracts and city specifications include automobile liability requirements in most cases; however, lessee insurance documentation typically did not include automobile liability insurance coverage.

In reference to property coverage requirements for community hangars, the leasing policy references lease contracts. However, the standard lease contract references back to the leasing policy.

Insurance certificates may not have been requested or retained in files. The City may not have been named as a certificate holder in some cases, or the certificate may not have been requested or retained in files.

Without insurance certificates, the Aviation Department cannot document whether lease account holders have the insurance coverage required by contracts. If a lessee's coverage changes or is dropped, and the Aviation Department does not receive notification about the change, the City's risk may be increased without the City's knowledge.

Recommendation 6: *The Aviation Director should ensure that insurance certificates or other supporting documents are obtained annually and maintained in lessee files. The department should coordinate policy documentation requirements with Risk Management for future contracts.*



Auditee Response: Partially Concur. The LC is currently working to get all insurance certificates updated and properly endorsed. Once the insurance certificate is properly endorsed, the LC will forward the insurance document(s) to Risk Management for their records.

Target Date: September 30, 2017

Responsibility: Sr. Administrative Assistant



Acknowledgements

The Department of Internal Audit would like to thank the Aviation and Information Technology Solutions Departments and the City Secretary's Office for their cooperation and assistance during this audit.