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AUTHORITY:	Boise City Code, 1-09-03 FY2017 Work Plan

OFFICE OF INTERNAL AUDIT ACTIVITY REPORT

TASK #17-01, Airport Leases

DATE OF ENGAGEMENT: November 28, 2016

INTRODUCTION

The first municipal airport in Boise Idaho was built in 1926 where the Boise State University campus now resides. The City of Boise started buying and leasing land for the current Airport location in 1936. The Department of Aviation and Public Transportation was created after the airfield was obtained by the City in 1946.

The Boise Airport primarily serves southwestern Idaho market, which also extends into eastern Oregon. Today, the market area for the Boise Airport includes approximately 675,000 residents. Based on the Fiscal Year 2016 activities, the Boise Airport served approximately 2,400,000 passengers and recognized approximately \$30,000,000 in operating revenue.

The Boise Airport conducts certain business-type activities, and exists as a proprietary fund of the City. The proprietary fund known as the Airport Fund accounts for all general operations, debt service, and capital additions of the municipal airport. Revenues such as hangar rent, terminal rent, landing fees, parking fees, and other charges, as well as the expenditures that support the maintenance and general operation of the facility are tracked in the Airport fund.

The Airport offers space for lease to a variety of tenants for varied uses, such as cargo facilities, corporate hangars, general aviation, medical transport, National Interagency Fire Center, Idaho Air and Army National Guard, customs and border patrol, and backcountry aviation. The Airport staff manages a total of 196 leases (at the time of the audit) which are categorized as follows: airfield, industrial / commercial, other, pasture, shade, terminal, T-hangar, and tie-down.

Individual lease agreements specify compliance requirements for leased premises of the Airport. The agreements dictate the permitted and prohibited uses of the leased facilities. Any default in performance of the covenants and conditions required may result in an immediate cancellation of the lease agreement by the Airport. For those leases associated with private aviation, the storage of aircraft and belongings associated with the routine care and maintenance of the aircraft are ordinarily permitted activities.

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SCOPE AND METHODOLOGIES

The purpose of the Airport Leases audit was to gain a reasonable degree of assurance that the control environment related to leases is adequate. The control environment should ensure that management / administration of the lease agreements is occurring in an efficient and effective manner, that goals and objectives are being met, and that activities comply with applicable policy, law, and / or regulation. Internal Audit has defined the following specific objectives for the review:

- Review to ensure proper oversight of the lease and contractual agreement activities.
- Review the accuracy of revenue records and ensure remittances occur timely based on the terms of the respective agreement.
- Review the procedures for delinquent accounts and determine adequacy of collection efforts.

Internal Audit established the scope of the review to include all Airport Lease activity that occurred beginning on October 1, 2014 and ending on September 30, 2016. Where necessary, work was performed with specific "as-of" dates, as indicated in the report sections that follow.

A combination of interviews, observations, and detailed attribute testing were utilized to accomplish the defined objectives. The methods employed and the evidentiary materials developed were deemed to be adequate to support the conclusions contained within this report.

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EVALUATION AND COMMENTS

Based on the review performed, administrative controls, processes, and the oversight efforts that facilitate the leases appear to be functioning in a “**Satisfactory**” manner.

(Refer to **Appendix A** for additional details concerning Internal Audit's existing grading scale.)

Through the procedures performed, Internal Audit confirmed the Airport staff have implemented the proper oversight activities for the lease agreements. While not complete, the Airport staff are currently developing a formal lease policy. The leases are managed through a database and other financial software. Performance of the transactional activities are distributed amongst various Airport staff.

Lease agreements are presented to the Mayor and City Council for approval. The Airport Director, by way of Boise Municipal Code Chapter 3-02 Section 3-02-03, is responsible for supervising and negotiating lease agreements at the Airport. Furthermore, the Airport Director has the authority to execute certain standard lease templates; specifically, for Shade Port and T-Hangars.

As previously mentioned, the Airport staff manages 196 lease agreements which are categorized as follows:

Property Type	Lease Count
Airfield	35
Industrial / Commercial	39
Other	11
Pasture	2
Shade	10
Terminal	36
T-Hangar	60
Tie-Down	3

A sample of thirty lease agreements was selected and detailed testing was performed to ensure all parties are fulfilling the requirements set forth by the lease agreement. We detected deficiencies in the retention of

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current certificates of insurance at the time of our inquiry. The contributing factor appears to relate to a need for strengthened controls over the activity.

The revenue generated by the lease agreements was also reviewed in order to ensure accuracy and timeliness of remittances. The transactional records for each respective lease were reviewed for accuracy based on the billable rate at the time of the audit (rates are periodically adjusted via lease-rate escalation clauses incorporated into the agreements). The payment records were then confirmed with the financial system as evidence of performance. While reviewing these same records, we also detected minor errors in the timeliness of remittances. The Airport staff review aging reports in an attempt to identify delinquent account balances. Management will then determine the appropriate action for certain delinquent accounts with efforts to collect on past due amounts. Internal Audit issued one Audit Comment related to aged balances of a lessee that is not contained within this report. The Audit Comment involved the entity's own internal business process and invoice routing, that is somewhat outside the scope of the audit. The issue has been addressed by the lessee; the account is now current.

Internal Audit also performed site visits to a pre-selected group of hangars at the Airport. Per the lease agreement, the hangars are generally to be used for the storage of one aircraft and other personal belongings associated with the routine care and maintenance of the stored aircraft. We observed several opportunities for improvement relative to the utilization of the hangars. The observations are noted in the Other Area of Concern section of this report.

The report sections that follow provide additional commentary on the work performed, and our findings, concerns, and recommendations relative to each respective area.

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FINDINGS AND RECOMMENDATIONS

Audit's Findings are detailed below; including any recommendations that were made, and management's responses to those suggestions.

FINDING: Lease Compliance

Internal Audit sampled thirty lease agreements maintained by the Airport (lessor). The lease agreements stipulate certain compliance requirements of the tenant (lessee). During the review, we noted requirements that may not have been achieved by the tenants. Of the thirty leases sampled, the following conditions were noted:

- Nine tenants did not appear to have current Certificates of Insurance on file with the Airport.
- Two tenants did not appear to remit their rent payments in a timely manner.

Tenants are required to provide the Airport with Certificates of Insurance, for the benefit of the lessor and lessee, and shall be filed as proof, per Section 6.01 of the Airport T-Hangar Lease Agreement. Furthermore, tenants are required to remit the monthly rental payments in advance on or before the first day of each month during the term of the lease, per Section 3.04 of the Airport T-Hangar Lease Agreement.

The Airport staff explained the insurance validation has not been obtained in a timely manner due to key staffing changes; however, those lease files currently lacking certifications have been flagged and staff are in the process of follow-up with the tenants to obtain the current Certificates of Insurance. The City is at risk of not being adequately protected from liabilities arising from lessee activities.

RECOMMENDATION:

Internal Audit recommends that management strengthen their controls to ensure that tenants remain in compliance with their obligation to provide Certificates of Insurance under the governing lease agreements. Additionally, Internal Audit recommends the Airport staff continue efforts to collect delinquent accounts. The Airport staff should also consider assessing late penalty charges in accordance with the agreements. Furthermore, the formal leasing policy (to be developed) should include

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steps to be taken during the review of delinquent accounts, sending delinquent notices, establish thresholds for write-offs, applying late fees and interest charges, and terminating lease(s) if necessary.

MANAGEMENT RESPONSE:

Airport management provided the following response:

Insurance Certificates

The airport staff member who is responsible for ensuring current insurance certificates are on file has done this without review of the work completed. In order to ensure this is completed each month and that the appropriate action is taken, the staff member will submit her work to the Deputy Director of Finance and Administration for review. Any expired insurance certificates that have not been obtained will then be followed up with as deemed appropriate by management (phone call, letter of default, etc.).

Past Due Accounts

Airport management has an established system of monitoring past due accounts and taking the appropriate action based on the circumstances. Management performs weekly review of the accounts and may assess late fees based on a multitude of factors including the customer payment history and number of payments that are past due. The airport assesses late fees and sends default letters, which provides the tenant a time in which to cure their default (pay all outstanding amounts due), when appropriate. If it appears to be an isolated incident that led to the past due balance, late fees may not be assessed.

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OTHER AREA OF CONCERN

Internal Audit utilizes "Other Area of Concern" comments to provide management with feedback on issues noted during a project that appear to deserve additional management attention. Audit issued the following comments during the engagement.

Lease Compliance

Airport staff maintain and lease aircraft storage hangers as a part of routine operations. A standard Lease Agreement is utilized for these arrangements that stipulates, amongst other things, how the hangers will be utilized, and the types of permitted activities that may be conducted therein. Generally, the hangers are for the storage of one airplane each, and other belongings that are associated with the routine care and maintenance of that stored aircraft.

Internal Audit performed site visits to a group of thirteen hanger sites on Boise Airport's premises on December 29, 2016. Ten of the sites were leased; another three were not. Of the ten that were leased, seven appeared to house vehicles, materials, or activities that were not consistent with the terms of the respective leases. The conditions we noted (and the corresponding sections of the lease) included the following:

- Three units housed one or more motorcycles or recreational vehicles; *(addressed in Lease Section 5.02 c.)*
- Five units contained excessive furniture or cabinetry; *(addressed in Lease Section 5.02 d.)*
- One unit contained a 30-gallon drum of possible De-Icer Fluid; *(addressed in Lease Section 5.04) and,*
- One unit housed a large quantity / variety of items that may or may not have been associated with routine care and maintenance. *(addressed in Lease Section 5.05)*

RECOMMENDATION:

Internal Audit recommends that management perform periodic site visits to ensure that lessees utilize the leased premises consistent with their obligations under the governing lease agreements.

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MANAGEMENT RESPONSE:

Airport management provided the following response:

We are developing a reporting form to be used by Airport Operation's staff during monthly fire extinguisher inspections. If any violations are observed, the form will be completed and returned to the Airport's Property/Contract Administrator who will follow up with a site visit and work with the tenant accordingly. Areas of extreme concern would be anything that would cause a fire risk or violation of the aeronautical use of the hangar. Reporting process will begin March of 2017.

CONCLUSION

Overall, the audit suggests the Airport staff effectively managed the lease agreements. The business practices and oversight implemented appear to be comprehensive. While Internal Audit did identify areas for improvement, the implementation of the recommendations noted within this report should strengthen the control environment.

Internal Audit would like to acknowledge and thank the staff and management of the Airport for their cooperation and assistance throughout the audit project.

MANAGEMENT PARTICIPANTS

Mike O'Dell, Airport Finance Deputy Director/Senior Manager
Amy Snyder, Airport Property/Contract Administrator

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APPENDIX “A”

Evaluation and Grading of Audits

Each audit will be evaluated or graded, and will receive one of the three following ratings. Grades will be assigned based on the perceived “best fit.” Thus, not all attributes associated with an assigned grade may be present within a given Department or Division.

- Satisfactory – No significant weaknesses or operational issues were noted during the audit. If any issues were noted, they did not materially detract from the business unit's ability to deliver services and / or to accomplish defined mission, goals, and objectives. Overall, systems of internal control are effective, and management oversight is adequate and effective.
- Needs Improvement – Weaknesses or issues detrimental to operational efficiency or effectiveness existed within the audited area, and were encountered frequently enough to lose the appearance of “isolated.” Issues noted were strongly suggestive of an impaired ability to provide services at needed levels, or to accomplish mission, goals, and objectives successfully. Internal control mechanisms may not be universally in place, implemented, or actively observed. Management oversight is weak.
- Unsatisfactory – Material or significant issues were noted within the operations under review. Issues posed risks that were mission-fatal; the business unit could not successfully deliver services in an acceptable fashion. Management failed to implement appropriate internal control mechanisms. Management oversight is ineffective, absent, or willfully avoided.