



DATE: June 1, 2010

TO: RUSSELL C. WIDMAR, Director of Aviation, Airports
BRENDAN CARMODY, Assistant Director of Aviation, Airports

THROUGH: RENENA SMITH, Budget Director *ef*
Budget and Management Studies Division

FROM: BOB KOURY, Principal Internal Auditor *Bob Koury*
Budget and Management Studies Division - Internal Audit

SUBJECT: FINAL AUDIT REPORT – AIRPORT REVENUE PROPERTY LEASE AUDITS

A sample of Airport's revenue property leases were recently audited by the City's Principal Internal Auditor, in accordance with AO 1-12 and Government Auditing Standards. Attached is the Final Audit Report and Airport's Management Responses to the audit findings and recommendations dated May 20, 2010.

Internal Audit will perform a follow-up audit six to twelve months after this report is issued to verify that each recommendation has been implemented or that the issue documented in the finding has been resolved in a manner that addresses the weakness or risk identified. The follow-up audit is performed in accordance with AO 1-12 and Government Auditing Standards.

We wish to thank the Airport staff for their assistance provided during the course of this audit. If you have any questions, please contact Bob Koury, Principal Internal Auditor, at 621-7072.

Attachment

cc: Ashley Swearingin, Mayor
City Councilmembers
Mark Scott, City Manager
Bruce Rudd, Assistant City Manager
Nicole Zieba, Deputy City Manager
James Sanchez, City Attorney
Joe Gray, Finance Director/City Controller
Dan Turner, Risk Manager, Risk Management Division
Michael Lima, MAIII, Airports Finance Manager, Airports



INTERNAL AUDIT

FINAL AUDIT REPORT

**Airport
Revenue Property Lease Audits**

**Performed By:
Bob Koury, Principal Internal Auditor
Budget and Management Studies Division – Internal Audit**

Issued on June 1, 2010

Executive Summary

Based on the results of this audit of a sample of the Airport's revenue property leases, the more significant audit findings are summarized below. This audit report is intended to assist both Airport Management and applicable Lessees in the performance of their responsibilities, administration, oversight and contract compliance related to their respective revenue property leases.

Key Audit Findings

- ▶ The Airport did not request a property appraisal of Fire Station #10 in October 2009, as required by the Property Lease. Based on the current real estate market and economic conditions in the Fresno area, a new appraisal of the Fire Station #10 property site completed in October 2009 may very well have resulted in a lower appraised value. The lower value would result in reducing the Airport's billable rent amount of \$10,000 to the Fire Department which was established by an appraisal performed in October 2004.
- ▶ The Surety Bond amount required by Atlantic Aviation was established at \$86,000 effective November 2003. With rental adjustments occurring in June 2006 and again in June 2009, the Surety amount was to have been increased to \$114,795 and again to \$130,156, respectively, on those dates. However, it remained at \$86,000 until this item was brought to the attention of the Airport staff during the audit and was corrected effective April 1, 2010.
- ▶ Certificates of Insurance for both the AVCRAD and Airways Golf Course Property Leases were not maintained in accordance with the insurance requirements of each lease. All AVCRAD leased parcels have not been included in their "self-insurance" policy since October 2001, and the endorsement for "City of Fresno, its officers and agents named as additional insured" was not included in the ClubCorp Airways Golf, Inc. Insurance Certificate.
- ▶ "Late Payment Charges" were not paid by the State, as required by the Airport and State AVCRAD Property Lease, for payments received by the Airport after the stipulated due dates within the Lease Agreement. All payments for the period October 2008 through February 2010 were received by the Airport after the due date. This issue was brought to the attention of the appropriate State Agency representative by Internal Audit. The State Agency has agreed that the Lease Agreement should be amended for clarity and specificity related to late payment rate, and that the State should comply with this provision for any future late payments issued to the Fresno Airport.

TABLE OF CONTENTS

INTRODUCTION

Background	1
Audit Objectives	1
Audit Scope and Methodology	1
Conclusion	2

REPORT SECTIONS – AUDIT RESULTS AND RECOMMENDATIONS

I. Airport and Fire Department Fire Station #10 Property Lease.....	3
II. Airport and Police Department “AG Farm” Property Lease.....	4
III. Airport and Atlantic Aviation Amended and Restated Property Lease.....	5
IV. Airport and Army Aviation Classification Repair Activity Depot (AVCRAD) Property Leases.....	6
V. Airport and California Air National Guard (CANG) Property Leases.....	7
VI. Airways Golf Course Lease.....	8

INTRODUCTION

Background

The Fresno Airport leases out several parcels of property they own to various type Lessees. Revenue from these many property leases equate to several million dollars a year for the Airport Operations. Airport Management and staff maintain these property leases and all related records and financial accounting systems at their Administration Office located at 4995 E. Clinton Way, Fresno, California.

As a result of our Citywide Risk Assessment Project and a high priority on revenues for the City, we considered it appropriate to audit a sample of the Fresno Airport's revenue property leases.

Audit Objectives

The primary audit objectives of this revenue property lease audit was to determine and provide assurances that:

1. The Contractor (Lessee) and Airport (Lessor) have established and maintain an adequate system of internal controls to assure that all monies due the City Airport by the Lessee are received, documented, and accurately reported;
2. Both Contractor and Department responsibilities, as stipulated and required by the Property Leases, have been adequately complied with by both parties; and
3. All applicable laws, regulations, policies and procedures have been adequately complied with by the Contractor and Department in the performance of these Property Leases.

Audit Scope and Methodology

Internal Audit performed this property lease audit during February – April 2010, in accordance with AO 1-12 and Generally Accepted Government Auditing Standards. The sampled property leases selected for audit were the following:

- Airport and Fire Department Fire Station #10 Property Lease - Expires on June 30, 2024
- Airport and Police Department "AG Farm" Property Lease - Expires on September 30, 2010
- Airport and Atlantic Aviation Amended and Restated Property Lease - Expires on April 30, 2025
- Airport and AVCRAD Property Leases - Expires on July 31, 2051
- Airport and CANG Property Leases - Expires on June 30, 2012
- Airport and ClubCorp Airways Golf, Inc. Property Lease - Expires on August 31, 2015

The total property lease revenue received by the Airport for the above sampled property leases audited is estimated at approximately \$1,400,000 per year.

To accomplish the audit objectives, Internal Audit thoroughly reviewed the sampled revenue property leases; interviewed Airport staff involved with the recordkeeping and oversight of the Airport's Property Leases; and tested applicable and sufficient records and documentation in order to form conclusions on the adequacy and accuracy of such property lease records for audit purposes. We performed other audit procedures as considered appropriate under the circumstances.

During the course of the audit, the Internal Auditor communicated audit findings of a more significant nature with Airport Management staff. An Audit Exit Meeting was held with Airport Management staff on April 27, 2010, to discuss all audit findings and proposed recommendations.

Conclusion

The Airport Management staff are to be commended for their efforts in the administration and recordkeeping of the many Airport property parcels and related property leases they are responsible to maintain on an ongoing basis.

Internal Audit has, however, identified some areas within this report related to the sampled revenue property leases audited and the overall administration and oversight of these property leases by Airport Management and compliance with the leases by the lessees. These specific areas need to be addressed for improved internal controls and enhanced contract compliance and recordkeeping purposes by both parties to the property leases.

REPORT SECTIONS – AUDIT RESULTS AND RECOMMENDATIONS

I. Airport and Fire Department Fire Station #10 Property Lease

The Fire Department and Airport Property Lease for Fire Station #10 is currently active and expires on June 30, 2024. The annual rent amount paid to the Airport by the Fire Department, effective January 1, 2005, is \$10,000. This amount was determined by an independent MAI Appraiser in October 2004.

The annual rental amount paid by the Fire Department to the Airport is to be “*adjusted to an amount equal to the then-current fair market rental value of the property site*” every five (5) years, per Article V of the Property Lease. Since the last MAI Appraisal of this property was completed in October 2004, there should have been another property appraisal requested and paid for by the Airport in October 2009; however, this appraisal was not requested nor performed and the annual rent continued at \$10,000 for January 2010, i.e. noncompliance by the Airport.

Based on the current real estate market and economic conditions in the Fresno area, a new appraisal of the Fire Station #10 property site, which should have been completed in October 2009, may very well have resulted in a lower appraised value of the property; thus, reducing the Airport’s billable rent amount to the Fire Department for Fire Station #10.

No other findings or exceptions were noted related to this Property Lease.

Audit Recommendations

1. The Airport should immediately comply with Article V of the Fire Station #10 property lease and request an independent appraisal of the Fire Station #10 property site by an MAI appraiser. The newly adjusted fair market rental amount for Fire Station #10 should then be formally communicated to the Fire Department and assessed accordingly. If the newly adjusted rental amount is less than the \$10,000 billed to the Fire Department for January 2010, an appropriate refund or credit should be given the Fire Department as a rental billing correction.
2. If both the Airport and the Fire Department agree that an independent appraisal of the Fire Station #10 property site is no longer necessary, as stipulated in Article V of the property lease, then that understanding should be formalized in writing between both parties as an Amendment or “side-letter” to the current property lease.

Management Response to Recommendations 1 & 2

See attached May 20, 2010 Airport Management Responses Memorandum.

Internal Audit Comment

As the Airport has indicated in their response, this is in fact, a “Memorandum of Agreement” (MOA) between the Airport and the Fire Department. However, it is still considered a binding agreement between the two parties and the terms and conditions are to be fully complied with by both parties. (See Exhibit A to this report – “Article V of the “MOA” specific to this audit finding.)

Internal Audit’s above noted findings and proposed recommendations are still considered appropriate under the circumstances.

II. Airport and Police Department “AG Farm” Property Lease

The Airport and Police Department Property Lease is currently active and expires on September 30, 2010. The annual rent amount to be paid to the Airport by the Police Department for use of the 22.72 acres “AG Farm” was \$11,360 (\$500 per acre) per year from October 2000 through October 2004, and was increased to \$12,723.20 (\$560 per acre) per year effective October 2005 through October 2009. (It should also be noted that the Fresno County Sheriff’s Department is invoiced by the Police Department 50% of the annual rent amount billed to the Police Department by the Airport for their usage of the “AG Farm” for the boarding and training of their mounted police horses.)

Audit testing of property lease billings by the Airport to the Police Department noted one exception: the October 2005 rent billing should have increased to \$12,723.20 per the property lease; however, only \$11,360 was billed to the Police Department, i.e. the Airport under-billed the Police Department \$1,363.20 for 2005. Although immaterial, all appropriate rent monies should be collected by the Airport from its lessees. Subsequent annual billings were completed correctly.

No other findings or exceptions were noted related to this Property Lease.

Audit Recommendation

3. The Airport staff should ensure they are billing all lessees the appropriate rental amounts as stipulated in the property leases, especially those leases that have escalating rental amounts that occur during the term of the property lease.

Management Response to Recommendation 3

See attached May 20, 2010 Airport Management Responses Memorandum.

Internal Audit Comment

As the Airport has indicated in their response, this is in fact, a "Memorandum of Agreement" (MOA) between the Airport and the Police Department. However, it is still considered a binding agreement between the two parties and the terms and conditions are to be fully complied with by both parties.

III. Airport and Atlantic Aviation Amended and Restated Property Lease

The Airport and Atlantic Aviation property lease is currently active and expires on April 30, 2025.

Per Article V, Section F. of the property lease, the Lessee (Atlantic Aviation) shall maintain a valid Surety Bond in an amount equal to three (3) months rent, effective June 1, 2006, and throughout the entire term of the lease. Effective June 1, 2006, the total monthly rent amount payable to the Airport by Atlantic Aviation was \$38,265. Multiplying this amount times three equals \$114,795, the contract required amount of the Surety Bond. The rent was adjusted again, effective June 1, 2009, to a total monthly amount of \$43,385. Multiplying this amount times three equals \$130,156. However, the Surety Bond amount has remained at \$86,000 since November 2003.

Upon notification to the Airport staff by Internal Audit on March 12th of the incorrect Surety Bond amount, they immediately requested an updated Surety Bond amount to be in compliance with the property lease. On April 6, 2010, a new Surety Bond was provided to Internal Audit in the amount of \$130,156, effective April 1, 2010.

No other findings or exceptions were noted related to this Property Lease.

Audit Recommendation

4. The Airport should more closely monitor the contractual requirements for Surety Bond coverage to ensure appropriate coverage is current and in compliance with the property lease throughout the entire term of the lease.

Management Response to Recommendation 4

See attached May 20, 2010 Airport Management Responses Memorandum.

IV. Airport and Army Aviation Classification Repair Activity Depot (AVCRAD) Property Leases

The Aviation Land Lease and Agreement between the Airport and AVCRAD was entered into on August 17, 1993. The leased premises are *"to be used for general military training and military aviation purposes."* Amendment No. 1 to this Agreement, effective 10/1/01, extended this Agreement through July 31, 2051.

Section 29 of this Agreement required the State to maintain a "self-insurance" policy to cover the leased premises. The most current Certificate of Insurance provided to Internal Audit was dated 1/19/94, which covered Parcels 1 & 2 and Joint Use Taxi Lane at the Fresno Airport. However, Amendment No. 1 to this Agreement, effective 10/1/01, Exhibit "2-A" references leased premises as Parcels 1, 2, 3, 4 & 5, and Joint Use Taxi Lane, i.e. the State's "self-insurance" policy has not included the additional Parcels 3, 4 & 5 since 10/1/01 and is in need of updating.

Audit Recommendation

5. The Airport should immediately request the State (AVCRAD) to update their current "self-insurance" policy to include all leased premises/parcels located at the Airport and monitor this insurance coverage on an ongoing basis throughout the entire term of the Lease.

Management Response to Recommendation 5

See attached May 20, 2010 Airport Management Responses Memorandum.

The Airport Use Agreement between the Airport and AVCRAD was entered into on August 17, 1993. Amendment No. 1 to this Agreement, effective 10/1/01, extended this Agreement through July 31, 2051.

Per Section 4. b. (2) of this Agreement, *"In the event any Airport Use Fee/Charge payment shall not be paid by State, as and when due, so as to be received by City by the twentieth (20th) day of the month immediately following the month for which such payment in arrears shall be due, State shall pay a late payment charge or interest (whichever shall then be more applicable/appropriate under State law) at such percentage rate as shall then be prescribed by State law."*

Monthly payments were tested for the period October 2008 through February 2010. As a result, all payments were noted as received after the due date, with the number of days late ranging from 2 to 77 days. However, the State did not pay any late payment charges for these late payments to the Airport, as required by Section 4. b. (2) of the Agreement.

A phone conversation regarding this particular provision of the Lease Agreement was conducted by Internal Audit with the State Agency personnel responsible for the administration of this Agreement. The State Agency representative concurred via email that this Section of the Agreement should be amended but still include a late payment charge provision, with a specific rate/percentage to be used by the State to calculate such late payment charges for remittance to the Fresno Airport whenever payments are received past the stipulated due date.

No other findings or exceptions were noted related to these Property Leases.

Audit Recommendation

6. Appropriate Airport Management and State Agency personnel should immediately discuss and resolve this particular provision of the Airport/AVCRAD Use Agreement, resulting in either an Amendment or "Side-Letter" to the Agreement to ensure any future late Lease Payments received by the Airport from the State will include an appropriate late payment charge.

Management Response to Recommendation 6

See attached May 20, 2010 Airport Management Responses Memorandum.

V. Airport and California Air National Guard (CANG) Property Leases

The current Airport Joint Use Agreement with CANG was effective 7/1/07 and expires on 6/30/12.

Section 8. of this Agreement is entitled "Fire Protection and Crash Rescue" and states: "*The parties to this Agreement have entered into a separate reciprocal fire protection agreement, which sets forth each party's responsibilities of fire protection and crash rescue services.*"

Upon request for the most current copy of the "separate reciprocal fire protection agreement", Airport staff provided Internal Audit with an agreement that was executed on July 1, 1983. Since this agreement is approximately 27 years old, it is unclear whether all terms, conditions, and requirements by the parties to this agreement are still current and accurate as of the audit date (April 2010). An outdated formalized agreement for reciprocal "fire protection and crash and rescue" activities at the Fresno Airport can cause possible health and safety risks and should be addressed immediately.

No other findings or exceptions were noted related to this Property Lease.

Audit Recommendation

7. The Airport and CANG personnel should immediately discuss and address the appropriateness and accuracy of the July 1983 "reciprocal fire protection agreement" to ensure both parties' responsibilities for fire protection and crash rescue at the Airport are clear and understood by both parties to the agreement. If necessary, a revised/updated agreement should be developed and executed to formalize these responsibilities as of April 2010.

Management Response to Recommendation 7

See attached May 20, 2010 Airport Management Responses Memorandum.

VI. Airways Golf Course Lease

The Airport and ClubCorp Airways Golf, Inc., formerly CCA Silband/GolfCorp, Inc. property lease became effective 9/1/89 and expires on 8/31/15.

Insurance – The current insurance coverage and limits required by the property lease are in accordance with the lease; however, nowhere on the current Certificate of Insurance is the "City of Fresno, California and its officers, employees and agents named as additional insured", as required by Article VI, B. 4. of the original Lease Agreement, for the Liability & Property Insurance components.

Upon notification to the Airport staff by Internal Audit on April 7th of the missing "additional insured" endorsement requirement for the Certificate of Insurance, they immediately requested this item be corrected by the lessee.

Audit Recommendation

8. The Airport should immediately request the appropriate "additional insured" verbage be added to the Certificate of Insurance for compliance with the Article VI, B. 4. of the Airport/CubCorp Airways Golf, Inc. property lease.

Management Response to Recommendation 8

See attached May 20, 2010 Airport Management Responses Memorandum.

Airways Golf Course Capital Improvement Fund – As general information only, this Property Lease stipulates that 6% of the total monthly green fee receipts are deposited into a separate Capital Improvement Fund. These monies are to be used solely for improvements and renovations of the leased premises (Airways Golf Course property), as considered

necessary and appropriate by both ClubCorp and Airport Management. A site visit and tour of the Golf Course by Internal Audit verified that this Golf Course is well managed and well maintained for both appearance and safety purposes.

The Cash Balance in the Airways Golf Course Capital Improvement Fund as of April 28, 2010, was approximately \$394,000.



FRESNO YOSEMITE
INTERNATIONAL AIRPORT

DEPARTMENT OF AVIATION

DATE: May 20, 2010

TO: BOB KOURY, Principal Internal Auditor
Budget and Management Studies Division – Internal Audit

FROM: RUSSELL C. WIDMAR, AAE, Director of Aviation
Fresno Yosemite International Airport - Airport Department

SUBJECT: RESPONSE TO INTERNAL AUDIT

Following are the Airports Department's responses to the findings of the internal audit conducted by you and reported in your memo dated April 29, 2010:

1. Airport and Fire Department Fire Station #10 Property Lease

Airports does not agree with this finding as we believe it is too narrowly focused in the facts and circumstances.

There is not really a "lease" between the Airports Department and the Fire Department. Both are departments of the same entity, the City of Fresno. An entity cannot make a lease with itself. There is a "Memorandum of Agreement" (MOA) between the departments, but even this is of dubious enforceability. Would/could the City sue itself?

Reading the initial recitations of the Memorandum of Agreement, it is obvious that the author was cognizant of the City's contractual obligation [under the substantial Airport Improvement Program grants that the City has accepted from the federal government] to operate the City's airports in a financially prudent manor, including realizing fair market value from the rental of airport lands. And the City has given similar assurances to the purchasers of the City's General Airport Revenue Bonds. But, the method chosen by the MOA's author for determining fair market value – hiring a qualified, third-party appraiser – has proven not cost/effective. Experience shows that the cost to Airports of hiring an appraiser far exceeds the potential rental increases. So, it would not have been financially prudent for Airports to hire an appraiser: it was more financially prudent to not adjust the Fire Department's rent.

2. Airport and Police Department "AG Farm" Property Lease

Airports agrees that the \$1,363.20/yr. rental increase should have started a year earlier than it did. We will attempt to collect this amount from the Police Department, based on the audit.

Again, this is not a "lease" – for the same reason that the above Fire Department MOA is not a lease. When Airports was asked by the Police to bill their sub-tenant (in effect, the Fresno County Sheriff's Department) for the latter's share of the rent, we did so as a matter of comity between City Departments: we weren't violating any lease language. Accommodating the Police had a budgetary advantage for that department and cost Airports nothing.

3. Airport and Atlantic Aviation Amended and Restated Property Lease

We agree and have required the tenant to increase the amount of its security deposit to correspond with their increased rent.

4. Airport and Army Aviation Classification Repair Activity Depot (AVCRAD) Property leases

We agree and have requested that the tenant revise its self-insurance to cover "all leased premises/parcels located at the Airport."

We acknowledge that this tenant has been chronically late in paying rent and that this lease provides for a late payment charge which we have not collected. However, in this lease, it's the tenant who determines what late charge would be appropriate [the State of California writes their own leases and they tend to be favorable to the State]. They have apparently decided that no late charge would be appropriate.

5. Airport and California Air National Guard (CANG) Property Leases

The Airports Department operates and maintains all the Aircraft Rescue and Fire Fighting (ARFF) equipment and trained personnel required by Part 139 of the Federal Air Regulations, and we get inspected by the Federal Aviation Administration at least every two years to assure compliance. CANG also operates and maintains firefighting equipment and personnel at the Airport – for reasons of their own. But CANG's doing so does not at all affect the requirements imposed on Airports by Part 139. Therefore, there are no "possible health and safety risks [that] should be addressed immediately" because of "an outdated formalized agreement for reciprocal fire protection and crash and rescue". In fact, Airports' ARFF responds to any aviation incident at the Airport, whether it be civil or military, regardless of what CANG's ARFF might do.

It is comforting that CANG's additional equipment and trained personnel are present and available and their agreement to assist, even in a civil incident, is appreciated. In fact, they have been performing cooperatively for years and years – so no need has arisen to re-visit the admittedly old cooperation agreement.

6. Airways Golf Course Lease

As noted in the audit report, appropriate "additional insured" verbiage was immediately added to Airway's Certificate of Insurance.

By the way, Airports wishes to thank Audit for verifying that funds in the Golf Course Capital Improvement Fund have been properly collected and accounted for – and for certifying the current fund balance at \$394,000.

cc: Mark Scott, City Manger
Bruce Rudd, Assistant City Manger
Nicole Zieba, Deputy City Manger
Renena Smith, Budget Director
Brendan P. Carmody, Assistant Director of Aviation
Michal Lima, Airports Finance Manger
Melissa Garza-Perry, Airports Property Specialist II

At any time during the effective term of this agreement, the Fire Department shall have the right to terminate this agreement and vacate the premises upon giving advance written notice of not less than six (6) months to the Airports Department.

ARTICLE V

RENT

During the effective term of this agreement, annual rental shall be paid to the Airport for the use of the premises by the Fire Department. The annual rental shall commence on the date this agreement becomes effective and shall be paid in lump sum each Fiscal Year with sufficient timeliness so as to be received on or before the first calendar day of January of each and every Fiscal Year beginning January 1, 1985, for the Fiscal Year July 1, 1984 - June 30, 1985, and continuing thereafter on or before January 1 of each and every Fiscal Year throughout the effective term of this agreement. Should the effective term of this agreement begin prior to July 1, 1984, then the rent for any such period prior to July 1, 1984, shall be pro-rated and shall be paid in lump sum in advance on or before the beginning date. Rental payments to the Airports Department shall be submitted to the following address:

City of Fresno
Finance Department
2348 Mariposa Street
Fresno, CA 93721
Attn: Airports Accounting

or to such other address as the Airports Department may from time to time direct in writing.

EXHIBIT A

The initial annual rental shall be Five Thousand Two Hundred Eighty Dollars (\$5,280.00). Beginning July 1, 1989, and each five (5) years thereafter, the annual rental amount shall be adjusted to an amount equal to the then-current fair market rental value of the site. The adjusted fair market rental value shall be determined by an appraisal performed by an independent MAI appraiser experienced in appraising business and industrial properties in the Fresno area. The appraisal will be paid for by the Airport.

ARTICLE VI

INDEMNITY

The Airport shall be indemnified and held harmless from any and all fines, suits, claims, damages, demands and actions of any kind and nature resulting from the Fire Department's use and occupancy of the premises or the activities and operations associated therewith. The Airport shall be protected against all risk in the Fire Department's operations hereunder and shall be fully indemnified and protected from damages for any and all accidents or injuries to persons or property.

ARTICLE VII

MAINTENANCE OF PREMISES

The Airport shall not be obligated to make any repairs, alterations, additions, or improvements in or to or upon or adjoining the leased premises or any structure or other improvement that thereafter may be constructed or installed thereon; but the Fire Department shall, at all times during the full term of this agreement,