



Memorandum No: 21/22-17

Date: September 6, 2022

To: Honorable Mayor and Commissioners

From: Patrick Reilly, CPA *PR*
Interim City Auditor

Re: Fort Lauderdale Executive Airport (FXE) Lease Compliance Audit

Conclusion

The City Auditor's Office (CAO) found the internal controls for FXE's Lease Management function need strengthening. This includes remediation of incomplete policies for the lease management process. Overall, the City may have forgone certain revenues based on the findings identified in this report. Additionally, there was non-compliance with lease provisions.

Objective

The objective of this audit was to determine if selected FXE Airport vendors/lessees complied with selected provisions of their respective lease contracts.

Scope and Methodology

The audit included review of a sample of eight (8) FXE Airport lessees' compliance with material lease provisions of their respective lease contracts during the audit period of fiscal years 2018 through 2020.¹ This sample of lessees included all four fixed base operators (FBOs) and comprised 18 leases of 36 total leases during the audit period, which covered approximately 60% of total annual rent.

The CAO conducted its assessment of internal controls using the May 2013 updated Internal Control—Integrated Framework established by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). The framework defines internal control, describes the components of internal control and underlying principles, and provides direction for all levels of management in designing and implementing internal control and assessing its effectiveness. The five components of the COSO framework are: control environment, risk assessment, control activities, information and communication, and monitoring activities.

The audit methodology included but was not limited to:

- Performing data reliability and integrity assessment of related computer systems, as applicable;

¹ There was a scope limitation noted in Finding 1 based on lack of adequate documentation, which limited testing.

- Reviewing applicable regulatory guidance, policies and procedures, and related requirements;
- Reviewing relevant contractual agreements and amendments, as applicable;
- Reviewing records and reports;
- Performing process walk-throughs and conducting a review of controls;
- Interviewing appropriate personnel; and
- Performing detailed testing on selected activities.

We have identified seven (7) Findings and three (3) Observations during the audit. A Finding results from a failure to comply with policies and procedures, rules, regulations, contracts and fundamental internal control practices. An Observation represents an opportunity to improve on design or functionality of an existing internal control. The audit's findings are a combination of internal control significant deficiencies and material weaknesses. See Exhibit 1 (page 18) for categories of findings.

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

Background

Fort Lauderdale Executive Airport (FXE) is an approximately 1,000-acre general aviation airport owned and operated by the City of Fort Lauderdale and is a division of the City Manager's Office. The FXE oversees the administration of land leases, development of airport property, as well as operates, maintains, and promotes the Executive Airport, Airport Industrial Airpark, and the Fort Lauderdale Downtown Heliport, which serves as a multimodal connection to and from the downtown business area.

Over the past 70 years, FXE has grown into one of the top general aviation airports in the country. The airport plays a vital role in South Florida and national airport systems, serving a variety of private, corporate, and government aviation needs and is home to over 500 based aircraft. It comprises 10 percent of all business jet aircraft based in Florida, and with approximately 170,000 general aviation and business jet aircraft takeoffs or landings in FY 2020, FXE is ranked as one of the top five (5) busiest general aviation airports in the United States.

In addition to flight operations, the Airport manages a 200-acre Industrial Airpark with more than two (2) million square feet of prime office, warehouse, and manufacturing space, which is a stabilizing force in the development of the Uptown Business District. According to the 2019 Florida Department of Transportation Florida Aviation Impact Study, FXE's impact on the local economy is nearly \$2.1 billion annually.

FXE is self-sustaining, using revenues generated from land leases and fuel flowage fees to fund operational costs. Surplus revenue is used as matching funds for capital improvement projects and to leverage state and federal grants.

In FY 2022 Budget, FXE has four (4) fixed based operators (FBOs) and 36 leases that are anticipated to generate \$9,069,671 in revenue funds for the FXE. These leases consist of aviation leases and non-aviation leases.

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FINDINGS

Finding 1 - FXE Management did not provide sufficient documentation to support that certain lease obligations were being met.

Condition

FXE Management lacked adequate supporting documentation for the following items:

1. No construction documentation was provided for all applicable lessees relating to,
 - a. Construction progress payments support or pay applications showing the construction start and end dates as related to the leases' construction deadlines and the value of the work completed as related to leases' minimum cost requirements;
 - i. Verification of construction progress was completed by visual inspection, which is also not documented.
 - b. Construction contracts requiring boilerplate provisions per lease;
 - c. Construction bonds; and
 - d. Construction contractors' insurance certificates.
2. Security deposit bond support for one lessee was not provided.
3. Support was not provided for one lease for potential additional rent. Additionally, the quality of the additional rent support for another three lessees was insufficient.
 - a. For example, only excel spreadsheets were provided for the additional rent support.
4. Market rate adjustment support, such as appraisals, were not provided for five of seven (5 of 7) sampled leases.
5. There were missing fuel invoices for three (3) lessees in support of fuel flowage revenue.²

Criteria

See Exhibit 3 (page 20-22) for verbatim lease requirements for Construction, Security Deposits, Additional Rent, Market Rate Adjustments, and Fuel.

Cause

FXE Management believed that lessee construction administration was handled through the Development Services Department (DSD), so they did not obtain or maintain construction related documentation.

Other exception conditions were attributed to lack of overall monitoring and management of leases by FXE Management.

Effect

Without adequate supporting documentation, FXE Management could not demonstrate that it properly managed lease compliance with the lease provisions or that the lessees are in compliance with lease provisions. Additionally, without adequate supporting documentation, the City would not be able to efficiently terminate a lease for lack of performance or seek other available relief under the agreement if a material default occurred.

² Eighteen fuel invoices were not found within support provided.

Recommendations:

The CAO recommends that the City Manager:

- Ensure that FXE Management is aware of all lessee obligations, maintains required lease documentation, and implements policies and procedures for monitoring agreement obligations;
- Periodically review the lease documentation maintained by FXE Management to ensure compliance with requirements and proper monitoring.

Management Response

Although the Airport Division maintains over forty years of lease history in hard copy form on Airport property as well as base lease provisions electronically, we look forward to having better controls available through the new Prodigy software. Airport staff will work with the Finance department and software vendor to recommend what additional features/controls may be of value to support monitoring of agreement obligations. Additionally, the Airport Division will review all lease policies and provisions and consult with legal counsel on relevant procedural updates within the next 120 days.

Finding 2 - FXE Management lacked adequate policies and procedures for lease operations.

Condition

Policies and procedures provided by FXE Management were incomplete, newly created or updated after the audit period, and missing basic internal controls. See Exhibit 2 (page 19) for details.

Additionally, the non-existence of an FXE leasing policy breached Policy and Standards Manual (PSM) 7.3.1, which required the creation of such a policy as of late 2017, just prior to the audit period.

Subsequent Event

Airport policy *FXE-008 Accounts Receivable* had not been updated and pre-approved by the Director of Finance in regard to transitioning performance of the rent collections process from outside contractor to in-house. This transition began after the audit period, on September 1, 2021, and was significant, impacting approximately \$700,000 receipts per month on approximately 40 leases. This was deemed non-compliance with PSM 9.10.1.

- Additionally, software was obtained in July 2021 to manage the new cash collections, but as of seven (7) months later (February 2022) the software had not been implemented nor policies updated for the software processes or controls.

Criteria

City Policy and Standards Manual (PSM) 7.3.1 *Acquisitions, Sale, or Lease of Real Property By the City of Fort Lauderdale* requires, "The Fort Lauderdale Executive Airport (FXE) will develop a separate policy indicating how various portions of this policy will be applied to properties owned by the FXE and related to statutory provisions regarding purchase, sale, or lease of real property by the FXE."

Additionally, FAA-sponsored best management practices as to airport policies, or Primary Management Compliance Documents (PMCDs), as recorded in the *Condition* statement, are indicated in Airport Cooperative Research Program (ACRP) Report 213.

Further, COSO Principle 2 requires "The board of directors ... exercises oversight of the development and performance of internal control." Additionally, COSO Principle 12 requires "the organization deploys control activities through policies that establish what is expected and procedures that put policies into action."

City Policy and Standards Manual (PSM) 9.10.1 Revenue Collections provides the requirements below. CAO's position is that though this PSM concerns "new revenues" and rent revenue is not new to FXE, this PSM still applies to the Airport's in-house rent collection process transition. Because the PSM only suggests a definition for "new revenues" (in terms of "may"), management within FXE and the Department of Finance should have considered the significance of the process change and acted in accordance with the PSM by revisiting Airport policy *FXE-008 Accounts Receivable* before the transition to ensure adequate internal controls exist.

"Prior to the initiation of any collections of new revenues detailed procedures shall be established by the collecting department and submitted to the Director of Finance, or his designated representative, and the Internal Auditor, or his designated

representative. This is to ensure that correct procedures and necessary controls are established in accordance with generally accepted accounting practices, and other applicable City policies.

New Revenues may be classified as monies or obligations to the City received from any source from which a revenue of the same nature has not been received within the last fiscal year and for which no pseudo code currently exists." (emphasis added)

Cause

The Aviation Advisory Board did not properly oversee the development of policies and procedures for lease operations.

Effect

Incomplete policies and procedures increase risk and the likelihood of errors or fraud going undetected. Additionally, without guidance FXE staff may not be aware of the proper processes or compliance requirements.

Recommendations:

The CAO recommends that the City Manager:

- Perform an adequate risk assessment to highlight areas of risk and concern with appropriate control design built to govern leases. When possible, software systems should be used with proper security configurations to enhance the controls environment, preferably administered by Information Technology Services (ITS).
- Develop and implement comprehensive policies and procedures for lease operations, flowing from the risk assessment. At a minimum, the policies and procedures should include all items in the conditions section of this finding; however, all policies and procedures should be reviewed to determine if there are other policies and procedures that may need to be developed or updated.

Management Response

We acknowledge the need to have better policies and procedures for lease operations. We will work with outside counsel and the Finance Department to develop clear policies and procedures. To initiate process, the Airport Division will review all lease policies and provisions and consult with legal counsel on relevant procedural updates within the next 120 days. Recently, the Airport purchased a lease management software package that is currently in the testing and commissioning phase. Airport staff has submitted to legal a draft policy for their review. Airport staff will continue to work with outside counsel and finance department to ensure that software controls align with the developed policies and procedures.

Finding 3 - Interest payments and penalties had not been billed or collected for late rent payments.

Condition

We found that there were approximately 500 late payments that totaled approximately 5,600 late days. We did not observe any interest payments or penalties that were charged for these late days.

Subsequent Event

In a letter to all airport tenants notifying them that the lease rent collection would be collected by FXE Management instead of the outside contractor beginning on September 1, 2021, FXE Management stated there was a 15-day grace period for late payments. This grace period conflicts with the lease provisions.

Criteria

See Exhibit 4 (page 23) for verbatim lease requirements for late payment penalties.

Cause

FXE management miscalculated the timing of the two late payment consequences within leases, believing a grace period was always applicable. The lease provision requires interest on late payment to commence upon the 1st day late, not after a grace period, and in addition to interest, the late penalty provision commences after grace/cure period.

Similarly, when collections were outsourced, the outside contractor miscalculated the interest and penalties by providing grace periods contrary to lease provisions.

Additionally, FXE Management, despite the airport collecting approximately \$700,000 per month from approximately 40 lessees on rent amounts that are consistent month after month, had not implemented a mandatory e-payment collections program that would automate timely rent payment by bank transfer at or before each due date. During the audit period and current practices, most lessees were writing physical checks and mailing them to a lock box.

Effect

By not billing or collecting the late interest payments and penalties, FXE has been underpaid by approximately \$30,000 total for the three-year audit period.

Recommendations:

The CAO recommends that the City Manager:

- Revise *FXE Policy #008 Accounts Receivable* to be consistent with the lease provisions;
- Consider implementing a mandatory e-payment program for any new tenants;
- Collect the owed interest and penalties for the prior late payments or have the City Commission waive the amounts owed; and
- Notify tenants / lessees that there is no grace period for late payments per the agreements and explain the lease provision.
- Consider implementing a late payment penalty within the City's airport lease template that is effective at incentivizing timely payment.

Management Response

All Airport leases contain provisions that address late payment and grace periods with respect to payments. The examination did consider a procedural grace period offered to tenants during a transition period from third-party lease administration to Airport Division lease administration. The Airport Division will evaluate the feasibility of the Auditor's recommendation with respect to e-payment. Airport staff will gather detail of pending balances of owed interest and penalties, and work with finance staff to determine appropriate treatment of balances consistent with PSM 9.10.2 – Allowance for and write-off of uncollectible accounts receivable.

Additionally, staff will review the recommendation of implementing late penalties to ensure balances are collected timely.

Finding 4 - In some instances, security and construction deposits had not been collected in accordance with the lease requirement.

Condition

In general, we found that security deposits and construction deposits³ that were required for the sampled lessees were collected; however, we noted the following exceptions:

- One of 18 lessees did not pay its security deposit valued at approximately \$125,000.
- Five of six security/construction deposits collected during the audit period were not timely.
 - One of these lessees provided coverage in bond form which omitted the first year, resulting in no coverage for that period.
- One lessee did not increase its security deposit upon declaring bankruptcy per lease requirement.
- One lessee did not forfeit its construction deposit of \$36,000 for failure to complete construction by the extended deadline.

Criteria

See Exhibit 5 (page 24) for verbatim lease requirements for security and construction deposits.

Cause

FXE Management did not consistently ensure the tenants properly paid the security and construction deposits.

Effect

There is approximately \$36,000 in escrow that is due to FXE for late completion of construction. Additionally, approximately \$125,000 should be collected from lessee and placed in an escrow account.

Recommendations:

The CAO recommends that the City Manager:

- Transfer the forfeited \$36,000 in escrow to a City-owned account;
- Collect the \$125,000 amount due to escrow;
- Design and implement policies and procedures to include periodic reconciliation of deposits to the lease provisions and the City's escrow account to ensure that lease provisions have been met;
- Review all other leases (that were not in the sample for this audit) for security and construction deposits to ensure they were properly collected; and
- Review all security deposits in escrow to ensure that they are correctly in escrow and resolve any discrepancies identified.

Management Response

The Airport Division will examine all leases and determine if deposits are recorded appropriately in escrow accounts with the Finance Department. The Airport Division will follow up with tenants where deposits are not recorded as escrow in the City's financial records to determine if the amount was received and if so how it was recorded in the City's records. Airport staff will work with Finance to ensure that deposits are recorded appropriately.

³ Only a sample of the leases were reviewed for the audit. FXE has other leases / tenants that may have the same lease provisions with similar exceptions.

Finding 5 - One of seven construction projects was not completed on time, yet no formalized amendment was approved by the City Commission to extend deadline for completion.

Condition

We found that one of seven construction projects required by lease, occurring during the audit period, was not timely completed. There were two lease amendments granting additional time, but there was no third lease amendment approved by City Commission to provide for the third deadline extension that was necessary to complete the construction project.

Criteria

See Exhibit 6 (page 25) for verbatim lease requirements for construction deadlines.

Additionally, per City Charter Section 8.10, "...the city commission acting through the city manager shall have the power to negotiate any and all leases of land within the city owned airport known as Fort Lauderdale Executive Airport...." As the City Manager requested approval from the Commission to enter into lease amendments negotiated to extend construction deadlines for this parcel in 2012 and 2016, it is our understanding that such Commission approvals are required by Charter when deadline extensions are needed.

Cause

It appears that there were construction delays, per the two amendments, based on multiple factors, such as, economy factors, construction design, and permitting difficulties.

FXE Management provides construction deadlines to prevent land banking; however, so long as progress is being made on the projects, FXE Management does not hold the lessee accountable to the exact deadline required in the lease.

Effect

When lease requirements are not met, the lessee should be held accountable for the requirements. If they are not accountable, it sets a precedent that the lease will not be enforced. This provides limited remediation options to the City when there is non-compliance.

In this instance, FXE Management imposed 5% penalties to increase the rent in the first two amendments. With the third amendment not approved, it is possible a penalty to increase the rent should have been implemented but was not.

Recommendations:

The CAO recommends that the City Manager ensure that all changes to lease requirements be formalized in a lease amendment and that all such lease amendments are approved by the City Commission, when required.

Management Response

Six of the seven leases were eligible for administrative extension, which were exercised by the City Manager, but not documented. The time-based requirements contained within the airport leases are designed to ensure the timeliness of capital improvements and prevent land banking by tenants. In the noted examination, the City executed two lease amendments for additional time to complete construction, however construction was completed before a third amendment could be brought to the Commission. Staff will ensure that any lease amendments are approved by the City Commission.

Finding 6 - It does not appear that all applicable subleases have received pre-approval by the City Commission.

Condition

It appears that four lessees within the audit sample entered into nonexempt subleases without prior approval, contrary to the lease requirement. Additionally, FXE Management had limited information about the lessees' sublease activity to show monitoring and compliance with the lease provision.

Criteria

See Exhibit 7 (page 26) for verbatim lease requirements for subleasing approvals.

Cause

FXE Management has not properly monitored subleases and tracked compliance with the lease provision requirements.

Additionally, the lease provision appears to be loosely designed for approval controls and monitoring of subleases. It does not address potential tenant changes that could subsequently occur without approval at the sublease level when the sublease is for one or more tenants.

Effect

Subleases that required approval and did not receive proper approval would be void. Additionally, due to the lack of subtenant information being tracked by FXE Management, it is unclear if the subleases are in compliance with the original lease provisions, as required by the original lease.

If the subleases are not reviewed and approved, it would cause noncompliance with the lease provisions and possibly FAA requirements.

Recommendations:

The CAO recommends that the City Manager:

- Identify and ratify subtenant leases that did not receive proper Commission approval;
- Design and implement policies and procedures that require adequate documentation and monitoring for subleases to ensure compliance with lease provisions and FAA requirements; and
- Collaborate with the City Attorney's Office for re-designing the lease provision for subleasing to ensure purpose/objective for required approvals is understood; adequate documentation is obtained; and FAA compliance is maintained.

Management Response

An existing provision in each non-aeronautical lease requires the prime tenant to provide notification to the Airport when a subtenant occupies greater than fifty one percent of the overall leasehold which triggers a requirement for City Commission approval. The Airport has two non-aeronautical subtenants that occupy greater than fifty one percent of the overall leasehold and both have been approved by the City Commission. The Airport will explore modification of lease language to a more administrative process for subtenant approval with the purpose of maintaining FAA compliance. Staff will also review any existing subtenant leases that have not received proper Commission approval and will get these ratified by the City Commission.

Finding 7 - File retention practices should be improved.

Condition

FXE Management exhibited delay or difficulty in promptly providing the auditor with requested lease documents, which should be readily available. Additionally, the City Clerk's Office indicated FXE Management had not provided the Clerk with all current airport lease documents that should be centralized in the Laserfiche retention service for all department's significant documents, which has been effective since approximately 2015.

Criteria

City Policy and Standards Manual PSM 1.5.1, "Agreements, Contracts, Leases: Execution policy and procedures," subsection 4(e) requires, "Upon approval for execution, the original document will be filed in the office of the City Clerk in the official files."

Cause

This exception appears to be attributable to lack of adherence over the years by various FXE Management teams since circa 1980, the year of the PSM.

While some of these documents are currently uploaded into the agenda system for the City Commission meetings, these are not the executed documents. It appears that there is a lack of awareness of this PSM and the requirement to provide the executed documents to the City Clerk to keep as the official files.

Effect

By not complying with the PSM to provide the original executed documents to the City Clerk, it is possible that there could be missing documents, or a lack of overall records being retained through proper channels. This could cause non-compliance with public records requests, as airport lease terms can span decades. This could also create issues when completing amendments if prior amendments are not properly retained and documented.

Recommendations:

The CAO recommends that the City Manager:

- Retrain FXE personnel on proper records retention practices and requirements; and
- Develop and implement policies and procedures to adequately maintain files in accordance with records retention requirements and completeness of the lease files.

Management Response

The Division, within the next sixty days, will schedule records retention training with the City Clerk's Office and will continue to coordinate with the City Clerk's Office on file retention efforts and best practices. Additionally, Airport staff will work with the Clerk's staff to develop policies for staff to follow and meet compliance.

OBSERVATIONS

Observation 1 - FXE Management did not define a clear fuel flowage revenue calculation lease provision.

Condition

We found that for the sampled lessees involving fuel farms, FXE Management completed the calculations for fuel revenues on an annual cumulative basis rather than monthly basis, which was not clearly defined in these leases.⁴

These leases provide a volume discount to lessees upon a 500,000 gallon threshold. As fuel flowage revenue due to FXE, prior to this threshold lessees owe FXE 5.5% of fuel cost, and after this threshold is reached lessees owe 3.5% of fuel cost (see Exhibit 8, page 27). However, most of the applicable leases currently don't include language concerning the timing of this threshold, which becomes important when a lessee delivers more than the threshold in any month.

For example, a three month period with monthly fuel flowage of 600,000 gallons per month at \$2.50 per gallon would produce fuel flowage revenue to FXE of \$232,500 under the monthly basis method or \$182,500 under the annual basis method. This is a \$50,000 total difference for the period. The initial month under both bases produces the same fuel flowage revenue because the 500,000 gallon threshold is reached for both bases in the first month. The difference arises in the subsequent months where the threshold of 500,000 gallons is reset only for the monthly basis method, resulting in this method incurring a rate that is 2% higher on the threshold volume for these two months (or \$25,000/month difference as 500K gals x \$2.50/gal x 2% rate difference).

Previously, the City's airport leases clearly established that the volume discount threshold was applied on an annual cumulative basis. However, a couple of decades ago, the City's airport leases removed this language as they were renewed or newly signed, to the effect these leases could read as if the volume discount should be applied on a monthly basis, contrary to how FXE Management charged for fuel flowage.

Criteria

See Exhibit 8 (page 27) for verbatim lease requirements for fuel flowage revenue calculation.

Additionally, the City Attorney opined that this provision applies to an individual monthly volume basis.

Cause

FXE Management stated that they completed the calculations on an annual cumulative basis because that was how prior FXE Management had completed the calculations for decades. The annual calculation basis was also established in airport policy *FXE-013 Fuel Flowage Report Procedures*, written January 12, 2021, after the audit period. Additionally, one or more decades-old leases and amendments required the calculations on an annual cumulative basis; however, the calculation language was changed in the more current leases, but a change in method is not clear and apparently was not explained to the lessees at the time of the change.

⁴ Note: this condition did not apply to one sampled lease during *most* of the audit period as it was previously operating under a fuel provision that clearly required annual basis calculation. However, the lease was amended and restated in April of 2020 which confused the calculation language.

Effect

As a result of using the annual basis calculation and not resetting the threshold each month, FXE did not maximize revenues. The approximate annual⁵ increase of revenue if the calculations were completed on a monthly basis, per audit analysis, is \$270,000 based on pre-COVID volumes of fuel delivered. This difference represents an increase of 35% on approximately \$800,000 total annual FBO fuel flowage revenues during the audit period. However, the vast majority of this effect applies to one lessee.

Conversely, it should be noted that the airport charges lessees fuel flowage as a percentage of fuel cost, which can result in airport earnings that exceed similar airports in this region that charge a flat fee (per gallon).

Recommendations:

The CAO recommends that the City Manager have the City Commission determine and approve lease amendments to clarify the fuel flowage calculation basis.

Management Response

Fuel flowage lease language and the application of fees has been in place since 1990 however, to ensure clarity, fuel flowage language in each lease has been amended pending approval by the City Commission. Amended leases will be coming forward in a very future meeting. Staff will work to ensure that all lease amendments address clear fuel flowage revenue calculation language and get such amendment approved by the City Commission.

Subsequent Event

The proposed amended lease language referred to in the management response was approved by the City Commission at their August 16, 2022 meeting.

⁵ Based on calendar year, not the audit period's fiscal years, to better align with FXE's fuel reporting.

Observation 2 - FXE Management did not verify lessees' self-reported fuel deliveries.

Condition

The lessees self-report fuel deliveries used for additional rent. FXE Management does not independently verify the totals reported and accepts the lessees' self-report totals shown on fuel purchase invoices provided by the lessees. Based on statistical analysis, it appeared that 4 of the 5 lessees were reporting reasonable amounts of fuel deliveries. It appeared 1 of the 5 lessees had potentially under-reported the fuel deliveries by a sufficient amount to warrant concern.⁶

FXE's fuel revenue stream as of Calendar Year 2020 totaled approximately \$550,000 collected on approximately 9,000,000 gallons of fuel deliveries self-reported by the fuel farm lessees. The majority of this revenue is from one lessee, which is not the lessee that was identified for potential under-payment of additional rent for fuel deliveries.

Criteria

See Exhibit 9 (page 28) for verbatim lease requirements for fuel audits.

Additionally, COSO provides in Principle 6 that the entity should consider the potential for fraud in assessing risks to the achievement of objectives.

COSO provides in Principle 10 that the entity selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

Cause

FXE lessees that have fuel farms (sales of fuel) are required by their leases, to self-report fuel volumes delivered monthly then pay a percentage of the totals as additional rent to FXE. The self-reporting nature of the activities is prone to inaccuracy if not independently verified by FXE Management. FXE Management did not complete independent reviews/audits of the lessees' self-reported fuel deliveries, though it is a contractual right.

Effect

Without internal controls in place, then it is possible that under-reporting of fuel sales may occur and go undetected or be inaccurately reported. This may cause the City to incur lost revenues.

Recommendation:

The CAO recommends that the City Manager develop and implement policies and procedures for independent verification of lessees' self-reported fuel deliveries and FXE fuel revenues.

Management Response

The Airport has seven fueling agents that receive fuel deliveries. Of those, one receives as many as four fuel deliveries each day. Currently, it is not feasible to observe each fuel delivery by each fueling agent. Additionally, fuel receipts are reconciled by Airport staff monthly. Staff will research the possibility of adopting new technology that may accurately report fuel deliveries and provide real time data.

⁶ These analyses were comparisons of fuel sales among FBOs based on square footage and quantity of aircraft based at each FBO.

Additionally, the analyses were based on estimations, which identified the possible under payment by one lessee. The CAO did not inquire of the FBO in question.

Observation 3 - Collection of lease rents require an independent verification control

Condition

In general, our testing determined that rent was accurately billed and collected during the audit period; however, internal controls need improvement.

During and prior to the audit period, an outside contractor performed the majority of the airport rent collection services. Airport personnel would perform an independent verification of the contractor's performance. The separation of incompatible duties ensured that variations in rent over time, such as additional rental amounts, inflation adjustments, and market rate adjustments, were monitored and billed accurately to lease requirements over the long duration of these leases. This is an important control system because these rent adjustments have a compounding effect over time.

However, our audit could not determine that this control system was operating consistently with the outside contractor, citing the few concerns below.

- Rent accuracy could not be determined for one lease because the appraisal method for its market rate adjustment deviated from lease requirement. The appraisal obtained by FXE Management was for market rent, which is not the same as land fair market value per lease requirement.
- As noted in the scope limitation finding, because supporting documentation was not provided,
 - Rent accuracy relating to market rate adjustments for a few sampled leases could not be determined; and
 - Additional rent, as a percentage of certain lessee sales, due under one lease could not be determined.

Further, going forward beyond the audit period, this control system has been eliminated because the rent collection services of the outside contractor were cancelled and brought in-house, starting in fiscal year 2022.

To compensate, a City department that is independent of the airport, such as Finance or Budget, would need to provide the same detailed level of lease understanding and monitoring that the outside contractor was providing.

- Note, this finding is distinct from our policy improvements recommendation in that it involves the internal control efforts of a department separate from the airport.

Criteria

COSO principle 10 requires "The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objective to acceptable levels; point of focus 53: Addresses segregation of duties."

See Exhibit 10 (page 29) for verbatim lease requirements for additional rents, inflation adjustments and market rate adjustments.

Cause

Bringing in-house the significant cash collection process eliminated independent verification.

The cause of the few noted conditions mentioned were respectively attributed to the factors below,

which support the need for continued independent verification:

- deviation from the lease requirement;
- deficient records management; and
- insufficient monitoring of lessee sales.

Effect

There was insufficient financial transparency related to rent revenue.

Recommendations:

The CAO recommends that the City Manager designate a financial oriented City department to implement detailed monitoring of airport leases and independent verification of FXE's newly insourced rent adjustment and collection process.

Management Response

Collection of rents and fees is an essential business function of the Airport Division. Similar to other City Departments, the Airport issues invoices and collects fees locally. For the period audited, a City contracted third-party was responsible for rent collection which resulted in deficiencies that ultimately lead to lease administration responsibilities returning to the Airport. Staff will research the potential of implementing controls to achieve recommendation of validating rent adjustments and collections.

c: Greg Chavarria, City Manager
 Susan Grant, Assistant City Manager/Director of Finance
 Anthony G. Fajardo, Assistant City Manager
 Alain E. Boileau, City Attorney
 David Soloman, City Clerk
 Rufus James, Executive Airport Director

EXHIBITS

Exhibit 1 - COSO Framework and Finding Categories

The CAO conducted its assessment of internal controls using the May 2013 updated Internal Control—Integrated Framework established by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). The framework defines internal control, describes the components of internal control and underlying principles, and provides direction for all levels of management in designing and implementing internal control and assessing its effectiveness. The five components of the COSO framework are: control environment, risk assessment, control activities, information and communication, and monitoring activities.

A Finding results from a failure to comply with policies and procedures, rules, regulations, contracts and fundamental internal control practices.

A finding is categorized as a “deficiency,” a “significant deficiency” or a “material weakness” as defined below:

- *A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis.*
- *A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.*
- *A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance will not be prevented, or detected and corrected, on a timely basis.*

Exhibit 2 - Finding 2 Details - Policies and Procedures; Internal Controls

FXE Management lacked adequate policies and procedures. Per FAA-sponsored best practices, the following additional policies at a minimum were expected:⁷

- Standard Leasing Policy
 - Setting forth the parameters for leasing airport land and improvements.
 - Applies to entities who want to occupy / use airport property (new or renewal of existing agreements).
 - Typical leasing parameters:
 - Approval Process for Leases and Documentation Requirements
 - Competitive Process
 - Demonstration of Immediate Need
 - Term and Reversion
 - Note: a policy as to the lease application process was provided, but this was a policy obtained from another entity that was not updated to reflect FXE operations.
- Rent Policy
 - Setting forth the parameters to establish and adjust rental rates associated with leasing, occupying, and using airport land and/or improvements.
 - Conveys the methodologies utilized by the airport sponsor to establish and adjust airport rents.
 - Typical leasing parameters:
 - Establish Market Rent
 - Negotiation and Competitive Process, per charter
 - Rate of Return
 - Airport Sponsor Financing
 - Adjustment of Rents

FXE Management lacked adequate internal controls within its existing policies and procedures. Per COSO, the following deviations from expectation were commonly noted:

- Duties are not assigned to specific positions.
- There are no controls to ensure data integrity and file retention.
- There is no separation of incompatible duties.
- There is no independent verification.
- There are no physical controls described.

⁷ When the lack of policies and procedures were specific to different findings, they were not re-mentioned in this finding to avoid duplication.

Exhibit 3 - Finding 1 Criteria (Scope Limitation)

The language of these provisions varies per lease, but the recent version of the lease template during the scope of the audit included, but was not limited to:

Construction

“The term of this Lease shall expire in the event Lessee fails to provide Lessor with satisfactory evidence that Lessee has constructed the Lessee Required Improvements with the minimum total capital expenditure of.... The minimum total capital expenditure as set forth above shall include all hard and soft costs and without limitation as related to the design approval, permitting, professional fees, demolition, site work, grading and construction of the Lessee Required Improvements.”

“Lessee agrees that prior to commencing any work or construction on the Premises, the Lessee shall require the contractor building the Improvements to maintain at all times a valid construction bond and a valid labor and material bond, which shall be in an amount not less than the amount covering the full amount of the work performed. Each bond must guarantee to the City the completion of the work being performed by the contractor as well as full payment of all suppliers, materialmen, laborers or subcontractors employed in completing the improvement.”

“Lessee agrees to include the following provisions in any contracts it enters into with contractors in connection with the construction and completion of any Improvements to the Premises: (1) In consideration of the sum of twenty-five (\$25.00) Dollars and other good and valuable consideration, the Contractor shall indemnify and hold the City of Fort Lauderdale, its agents, officers and employees harmless from and against or on account of any injuries or damages, received or sustained by any person, persons or entity arising out of or in any way connected with the operations or work to be performed on the subject property, including during any warranty period, by or in consequence of any negligence (excluding sole negligence of City), by use of any improper materials, by any intentional act, by any misconduct or recklessness, or by or on account of any other act or omission of said Contractor or its subcontractors, sub-subcontractors, materialmen, or agents of any tier or their respective employees. (2) Contractor agrees to indemnify and hold the City of Fort Lauderdale harmless, including during any warranty period, against any claims or liability arising out of or in any way connected with the violation of any state, federal, City or local laws, ordinances, statutes, rules or regulations by Contractor, its subcontractors, agents, servants or employees. Contractor agrees to indemnify and hold the City of Fort Lauderdale harmless from all such claims and fees, and from any and all suits and actions of every nature and description that may be brought against the City on account of any claims, fees, royalties or costs for any invention or patent, and from any and all suits and actions that may be brought against City including during any warranty period for the infringement of any and all patents or patent rights claimed by any person, firm or corporation. (3) Contractor further agrees to indemnify and hold the City of Fort Lauderdale, its agents, officers and employees harmless, from and against or on account of any injuries or damages, received or sustained by any person, persons, or entity arising out of or in any way connected with patent construction defects. (4)

These indemnifications shall survive the term of this Contract. In the event that any action or proceeding is brought against the City by reason of any such claim or demand, Contractor, upon written notice from City shall resist and defend such action or proceeding by legal counsel satisfactory to City."

"Lessee agrees to include the following insurance provisions in any contracts it enters into with contractors in connection with the construction and completion of any Improvements to the Premises, and Lessee further agrees to provide City, prior to commencement of any Improvements, certificates of insurance evidencing the contractor's compliance with this Paragraph: (1) Without limiting any of the other obligations or liabilities of Contractor, Contractor shall provide, pay for, and maintain in force until all of its work to be performed under this Contract has been completed and accepted (or for such duration as is otherwise specified hereinafter), the insurance coverages set forth herein. All policies shall be endorsed to provide City with at least thirty (30) days prior written notice of any modification, cancellation, restriction or termination to the policy. a. b. C. d. Workers' Compensation Insurance in compliance with the Workers' Compensation Law of the State of Florida and all applicable federal law. Employers' Liability with policy limits of One Hundred Thousand Dollars (\$100,000) per accident. Comprehensive General Liability with minimum limits of One Million Dollars (\$1,000,000.00) per occurrence, combined single limit for Bodily Injury Liability and Property Damage Liability. The City of Fort Lauderdale shall be named as an additional insured. Business Automobile Liability with minimum limits of One Million Dollars (\$1,000,000.00) per occurrence, combined single limit for Bodily Injury Liability and Property Damage Liability, and which covers owned, leased, hired and other non-owned vehicles."

Security Deposits

"The Lessee shall post a security deposit with the City equal to three (3) monthly installments of rental ("Security Deposit") due under Paragraph 8, Rent. The Security Deposit shall serve as security for the payment of all monies due to Lessor and shall also secure the performance of all obligations of Lessee to the Lessor."

Additional Rent

"In addition to the above sums, Lessee shall cause to be paid to Lessor, as additional rent, in monthly installments due on the fifteenth (15th) day of each and every month during the Lease Term, [stated] percent of the gross monthly hangar rental receipts, such receipts being measured in monthly increments from the first day of the month coinciding with the Commencement Date."

Market Rate Adjustment

"Base Rent shall be further adjusted on the 5th, 10th, 15th, 20th and 25th anniversaries of the Commencement Date of the Lease Agreement to reflect either [stated] percent of the appraised value of the land or the current new annual rental established at the time of the adjustment, whichever is greater."

Fuel

"In addition to the above sums, the Lessee shall cause to be paid to the Lessor as additional rent the sums provided in Paragraph 13, Aviation Fuels, pertaining to the delivery to the Premises of any octane-rated fuels, jet fuels and lubricating oils (referred to as "Fuel" and "Oil") by Lessee, its sublessees, agents or independent contractors. The sums mentioned below shall not be considered as rent for the Premises, but shall be collected in the same manner as rent, including interest as provided in this Lease Agreement, accruing upon any late payments of such sums. ...

The Lessee shall further retain upon the Premises all delivery bills, invoices, and related records pertaining to the delivery to the Premises of aviation fuels and lubricating oils and shall produce and make available such books and records upon request by the Lessor for the purposes of auditing payments to the Lessor as provided in this Lease Agreement."

Exhibit 4 - Finding 3 Criteria (Late Payment Penalties)

The language of these provisions varies per lease, but a recent version of the lease template applicable to the scope of this audit was:

“Rent shall commence as set forth below. All rental payments shall be paid in advance in equal monthly installments, plus applicable taxes, on the first day of each month to which applicable according to the following schedule...”

“INTEREST. All delinquent payments to the Lessor shall bear interest at the rate as set forth in Section 8(d), Late Payment, of this Lease Agreement. Such interest shall be calculated from the due date, exclusive of any grace period, to the date of payment, on a daily basis, and will be due and payable when billed.”

“Late Payment. The Lessor shall be entitled to collect interest at the rate of [stated] percent per annum from the date due until the date paid on any amounts that are past due beyond any applicable cure period. Lessor's right to require payment of such interest and the obligation of the Lessee to pay the same shall be in addition to and not in lieu of the right of Lessor to enforce other provisions in this Lease, including termination of the Lease Agreement, and to pursue other remedies as provided by law.”

Exhibit 5 - Finding 4 Criteria (Security and Construction Deposits)

The language of these provisions varies per lease, but a recent version of the lease template applicable to the scope of this audit was:

“The Lessee shall post a security deposit with the City equal to three (3) monthly installments of rental ("Security Deposit") due under Paragraph 8, Rent. The Security Deposit shall serve as security for the payment of all monies due to Lessor and shall also secure the performance of all obligations of Lessee to the Lessor. The Security Deposit shall be in the form of an Irrevocable Letter of Credit ("Letter of Credit") or surety bond in form and substance satisfactory to Lessor or in cash.”

As to timeliness of security deposits, a deadline could not be found in the lease template. Audit testing applied a 30 day cure period from lease commencement per default provision:

“Except as otherwise specifically provided in this Lease Agreement, the Lessee shall have a grace period of thirty (30) days within which to pay any and all sums of rent due, which sums shall be due and payable without notice or demand, which Lessee waives.”

Regarding construction deposits:

“Upon execution of this Lease, a Construction Assurance Deposit in the amount of... shall be given to the City in Lessee's discretion as either in the form of cash or an Irrevocable Letter of Credit or Surety Bond in the form and substance satisfactory to Lessor to assure that construction of the Required Lessee Improvements...occurs prior to the Construction Deadline.”

Particular to the bankruptcy filing:

“Should the Lessee, at any time during the term of this Lease Agreement, suffer or permit an involuntary or voluntary petition in bankruptcy to be filed against it, or institute a composition or an arrangement proceeding under Chapters 7, 11, or 13 of the Bankruptcy Code or as the same may be amended from time to time, the , Lessee agrees to provide adequate protection and adequate assurance of future performance to the Lessor which will include, but not be limited to the following: ... (2) An additional two (2) months of advance rental will be required as additional security of future performance which must be paid to the Lessor within ten (10) days of the filing of the petition in bankruptcy...”

Exhibit 6 - Finding 5 Criteria (Untimely Construction Completion)

Content below is from the 2016 Second Amendment of the affected lease, establishing a March 2018 deadline for Phase 2 construction that was subsequently missed, requiring a third amendment. To be clear, this amendment allowed for an extension through roughly mid-January 2018, as 332 days after a building permits deadline of October 15, 2016, plus two periods of 60 days grace. However, according to an FXE memo dated April 26, 2018, permits were obtained a couple of months beyond the allowable grace periods, resulting in an effective extension for Phase 2 completion of mid-March 2018.

“The parties acknowledge and agree that the Term of this Lease Agreement commenced on November 1, 2009 (“Commencement Date”), and shall terminate thirty (30) years thereafter, unless sooner terminated as provided in this lease. The term of this Agreement will expire twelve (12) months from its Commencement Date if Lessee fails to provide City with evidence that it has expended funds for the renovation or improvement of the Premises equal to the minimum investment of Two Hundred Thousand (\$200,000.00) Dollars. Thereafter, this Agreement will automatically terminate if Lessee fails to provide City with evidence that Lessee has constructed the Phase II Improvements which support a minimum investment of One Million Eight Hundred Thousand and No/100 Dollars (\$1,800,000.00) within Three Hundred Thirty Two (332) days after issuance of all building permits by all regulatory authorities.”

“Building Permits. Lessor shall use its best efforts secure all building permits for Phase II Improvements on or before October 15, 2016. The City Manager, in his sole discretion, shall have the option to grant two (2) sixty (60) day extension to allow Lessee to secure building permits for Phase II Improvements upon written request (prior to October 16, 2016) from Lessee which shall include an explanation of why an extension should be granted which explanation may include but is not limited to delays caused by regulatory authorities which are outside the control of Lessee.”

FXE memo to Aviation Advisory Board, April 26, 2018:

“Records from the Building Department indicate that the master building permit was issued on April 21, 2017 resulting in a Phase II construction deadline of March 19, 2018....Based on a visual inspection, the required phase II construction has not been completed. There is still a significant amount of work left to be done....”

Additionally, regarding the two 5% penalties imposed for prior missed Phase 2 construction deadlines in 2012 and 2016, respectively:

“WHEREAS, on consideration for the additional time, [Lessee] has offered to increase the current rent by five percent, effective on the date of the amendment....”

“WHEREAS, as a condition to Lessor’s consent to extend the deadlines, Lessor requires an increase in the Base Rent....Effective upon approval of this Second Amendment by the City Commission of Lessor, Base Rent shall increase by five (5%) percent....”

Exhibit 7 - Finding 6 Criteria (Subleasing Preapproval)

The common lease provision for three of the four exceptions:

“(a) Except as provided herein, the Lessee shall not assign, sublease, sublet, transfer, convey or pledge this Lease Agreement or any of its obligations, in whole or in part, in any manner whatsoever, to any other natural or corporate Person; or any entity whatsoever, without the express consent of the Lessor, authorized by appropriate municipal action taken at a regular public meeting of the City Commission of the City of Fort Lauderdale; provided, however, that such consent will not be required for any subtenancy in which less than fifty-one percent (51 %) of usable floor area of any one building will be subleased by any one subtenant, nor to any sublease of any aircraft hangar space. Any such consent to an assignment, sublease, transfer, conveyance or pledge by the Lessor shall be subject to all of the terms and provisions of this Lease Agreement, and shall not release the Lessee from its obligations under this Lease Agreement, unless otherwise stated. The obtaining of any consent shall not affect the rentals payable to Lessor. Lessor agrees that consent will not be unreasonably withheld. However, Lessor may withhold consent in the event that a default has occurred hereunder, which default remains uncured. (b) Should Lessee take any action to assign or sublease this Lease without the prior written consent of the City, then any such assignment or other action shall be null and void and of no force and effect. In addition to all other legally available remedies, the City shall, upon written notice to Lessee and an opportunity to cure, be entitled to immediately terminate this Agreement.”

As to one lease with a unique subleasing provision:

“Lessee shall not assign, sublease, sublet, transfer, convey or pledge this Amended and Restated Lease or any of its obligations, in whole or in part, in any manner whatsoever, to any other natural or corporate Person, or any entity whatsoever, without the express consent of the Lessor, authorized by appropriate municipal action taken at a regular public meeting of the City Commission of the City of Fort Lauderdale. This provision does not apply to subleases to aircraft owners for hangar space or tie-downs. (b) Should Lessee take any action to assign or sublease this Amended and Restated Lease without the prior written consent of the City, then any such assignment or other action shall be null and void and of no force and effect. In addition to all other legally available remedies, the City shall, upon written notice to Lessee and an opportunity to cure, be entitled to immediately terminate this Agreement.”

Exhibit 8 - Observation 1 Criteria (Fuel Flowage Revenue Calculation)

The language of the fuel flowage provision varies per lease, but the recent version in the lease template during the scope of this audit was:

“The parties agree that the following sums are those to which the provisions above apply, and shall be paid to Lessor on a monthly basis:

Five and one-half percent (5-1/2%) of the per gallon cost price to Lessee of the first five hundred thousand (500,000) gallons of fuel delivered to Premises, and three and one-half percent (3-1/2%) of the cost price of each gallon exceeding five hundred thousand (500,000) gallons, of all aviation fuels delivered to Premises.

Remittances to Lessor shall be paid monthly not later than the 15th day of each month without any additional grace period and accompanied by a monthly report prepared by Lessee, which report shall detail the gallon amounts of any and all fuel delivered to the Premises. Such monthly reports shall pertain only to the Lessee's operations conducted at the Airport and exclude any other operations of the Lessee conducted at other locations.”

In contrast, the following is language from the decades-old lease template where annual cumulative basis is explicit:

“Such separate Agreement shall be known as a Fuel and Oil Flowage Agreement. By its provisions such agreement shall provide that Lessee shall authorize any and all of its fuel and oil deliverers to collect all fees and over-charges relating to all fuels and oils delivered to Lessee at the rates provided below, and remit the same directly to Lessor, in the time and manner provided below. Such remittance is to be paid monthly and accompanied by a monthly report prepared by deliverer, which report shall detail the gallon amounts of any and all fuel and oil delivered to Lessee.

(1) The following sums are those to which the provisions above apply:

Five and one-half percent (5-1/2%) of the per gallon cost price to Lessee of the first five hundred thousand (500,000) gallons, and three and one-half percent (3-1/2%) of the cost price of each gallon exceeding five hundred thousand (500,000) gallons, of all aviation fuels delivered to the Lessee at the airport, and six and one-half cents (6-1/2¢) per gallon on all lubricating oils delivered to the Lessee at the Airport. Such computations shall commence upon the date of this Agreement and shall be **computed upon a calendar year basis for the duration of the Lease.**” (emphasis added)

Exhibit 9 - Observation 2 Criteria (Fuel Audits)

Rent provision (recent version lease template paragraph 8) and fuel provision (recent version lease template paragraph 13) – example excerpts below, respectively:

“In addition to the above sums, the Lessee shall cause to be paid to the Lessor as additional rent the sums provided in Paragraph 13, Aviation Fuels, pertaining to the delivery to the Premises of any octane-rated fuels, jet fuels and lubricating oils (referred to as "Fuel" and "Oil") by Lessee, its sublessees, agents or independent contractors. The sums mentioned below shall not be considered as rent for the Premises, but shall be collected in the same manner as rent, including interest as provided in this Lease Agreement, accruing upon any late payments of such sums.”

“The parties agree that the following sums are those to which the provisions above apply, and shall be paid to Lessor on a monthly basis:

Five and one-half percent (5-1/2%) of the per gallon cost price to Lessee of the first five hundred thousand (500,000) gallons of fuel delivered to Premises, and three and one-half percent (3-1/2%) of the cost price of each gallon exceeding five hundred thousand (500,000) gallons, of all aviation fuels delivered to Premises.”

“...Lessor shall have the right, upon reasonable notice to Lessee, to audit the Lessee's books and records relating to Lessee's operations in order to determine the correctness and accuracy of the fuel fees paid to Lessor during a Lease year.”

Exhibit 10 - Observation 3 Criteria (Independent Verification of Rent Collections)

The language of these provisions varies per lease, but a recent version of the lease template applicable to the scope of this audit relevant to additional rents, inflation adjustments, and market rate adjustments:

Additional Rent Adjustment

"Additional Rent for Gross Rental Receipts. It is agreed between Lessor and Lessee that the New Annual Rent specified above shall be further adjusted at annual intervals commencing on [date], to include [stated] percent of gross rental receipts from the calendar year preceding each Adjustment Date for the improvements identified in Exhibit "B" herein."

Inflation Adjustment

"It is agreed between Lessor and Lessee that the Initial Base Rent (and Base Rent once commenced), for the remainder of the term of this Amended and Restated Lease shall be subject to annual increases and such increase will be calculated in accordance with the following terms and conditions:

Base Rent increases. Lessor and Lessee agree that the Initial Base Rent and thereafter "Base Rent" for the remainder of the term of this Amended and Restated Lease shall be subject to an increase at annual intervals effective [date] of each year. The first increase will become effective on [date]. Such adjustments shall be based upon the Cost of Living Index known as the Consumer Price Index (All Items. 1982-84 = 100), United States, All Urban Consumers, published by the Bureau of Labor Statistics of the United States Department of Labor. For computation purposes, the Numerator and Denominator are defined as follows:

Numerator - The Consumer Price Index for the [corresponding] month preceding each Adjustment Date.

Denominator- The Consumer Price Index for the [corresponding] month preceding the Adjusted Rent Commencement Date of the lease term.

The resulting fraction shall be applied to the base annual rental to arrive at the new annual rental.

Market Rate Adjustment

"Base Rent shall be further adjusted on the... anniversaries of the Commencement Date of the Lease Agreement to reflect either [stated] percent of the appraised value of the land or the current new annual rental established at the time of the adjustment, whichever is greater."

Appendix - Acronyms

ACRP	Airport Cooperative Research Program
CAO	City Auditor's Office
COSO	Commission of Sponsoring Organizations of the Treadway Commission
DSD	Development Services Division
EWP	Electronic Workpaper
FAA	Federal Aviation Administration
FBO	Fixed Base Operator
FDOT	Florida Department of Transportation
FXE	Fort Lauderdale Executive Airport
ITS	Information Technology Services
PMCD	Primary Management Compliance Documents
PSM	Policy and Standards Manual

FULL TEXT OF MANAGEMENT RESPONSES



Memorandum

Memorandum No: 22-22

Date: August 8, 2022

To: Patrick Reilly, Interim City Auditor

From: Greg Chavarria, City Manager 
Greg Chavarria (Aug 10, 2022 10:34 EDT)

Re: FXE Lease Compliance Audit – Management Responses –

Management appreciates the City Auditor examining select FXE Airport leases for compliance with selected provisions of their respective lease contracts. The examination identified Findings and Observations that will be addressed by Management.

The following are Management Responses to the examination Findings:

Finding 1

Finding: FXE Management did not provide sufficient documentation to support that certain lease obligations were met.

Recommendation:

The City Manager:

- Ensure that FXE Management is aware of all lessee obligations, maintains required lease documentation, and implements policies and procedures for monitoring agreement obligations.
- Periodically review the lease documentation maintained by FXE Management to ensure compliance with requirements and proper monitoring. should review its procurement policies and procedures for clarity.

Management Response

Although the Airport Division maintains over forty years of lease history in hard copy form on Airport property as well as base lease provisions electronically, we look forward to having better controls available through the new Prodigy software. Airport staff will work with the Finance department and software vendor to recommend what additional features/controls may be of value to support monitoring of agreement obligations. Additionally, the Airport Division will review all lease policies and provisions and consult with legal counsel on relevant procedural updates within the next 120 days.

Finding 2

Finding: FXE Management lacked adequate policies and procedures for lease operations.

Recommendation:
The City Manager:

- Perform an adequate risk assessment to highlight areas of risk and concern with appropriate control design built to govern leases. When possible, software systems should be used with proper security configurations to enhance the controls environment, preferably administered by Information Technology Services (ITS).
- Develop and implement comprehensive policies and procedures for lease operations, flowing from the risk assessment. At minimum, the policies and procedures should include all items in the conditions section of this finding; however, all policies and procedures should be reviewed to determine if there are other policies and procedures that may need to be developed or updated.

Management Response

We acknowledge the need to have better policies and procedures for lease operations. We will work with outside counsel and the Finance Department to develop clear policies and procedures. To initiate process, the Airport Division will review all lease policies and provisions and consult with legal counsel on relevant procedural updates within the next 120 days. Recently, the Airport purchased a lease management software package that is currently in the testing and commissioning phase. Airport staff has submitted to legal a draft policy for their review. Airport staff will continue to work with outside counsel and finance department to ensure that software controls align with the developed policies and procedures.

Finding 3

Finding: Interest payments and penalties had not been billed or collected for late payment.

Recommendation:
The City Manager:

- Revise FXE Policy #008 Accounts Receivable to be consistent with the lease provisions
- Consider implementing a mandatory e-payment program for any new tenants
- Collect the owed interest and penalties for the prior late payments or have the City Commission waive the amounts owed; and

- Notify tenants/lessees that there is no grace period for late payments per the agreements and explain the lease provision.
- Consider implementing a late payment penalty within the City's airport lease template that is effective at incentivizing timely payment.

Management Response

All Airport leases contain provisions that address late payment and grace periods with respect to payments. The examination did consider a procedural grace period offered to tenants during a transition period from third-party lease administration to Airport Division lease administration. The Airport Division will evaluate the feasibility of the Auditor's recommendation with respect to e-payment. Airport staff will gather detail of pending balances of owed interest and penalties, and work with finance staff to determine appropriate treatment of balances consistent with PSM 9.10.2 – Allowance for and write-off of uncollectible accounts receivable.

Additionally, staff will review the recommendation of implementing late penalties to ensure balances are collected timely.

Finding 4

Finding: In some instances, security and construction deposits had not been collected in accordance with the lease requirement.

Recommendation:

The City Manager:

- Transfer the forfeited \$36,000 in escrow to a City-owned account
- Collect the \$125,000 amount due to escrow.
- Design and implement policies and procedures to include periodic reconciliation of deposits to the lease provisions and the City's escrow account to ensure that lease provisions have been met.
- Review all other leases (that were not in the sample for this audit) for security and construction deposits to ensure they were properly collected; and
- Review all security deposits in escrow to ensure that they are correctly in escrow and resolve any discrepancies identified.

Management Response

The Airport Division will examine all leases and determine if deposits are recorded appropriately in escrow accounts with the Finance Department. The Airport Division will follow up with tenants where deposits are not recorded as escrow in the City's financial records to determine if the amount was received and if so how it was recorded in the

City's records. Airport staff will work with Finance to ensure that deposits are recorded appropriately.

Finding 5

Finding: One of seven construction projects was completed on time, yet no formalized amendment was approved by the City Commission to extend deadline for completion.

Recommendation: The City Manager ensure that all changes to lease requirements be formalized in a lease amendment and that all such lease amendments are approved by the City Commission, when required.

Management Response

Six of the seven leases were eligible for administrative extension, which were exercised by the City Manager, but not documented. The time-based requirements contained within the airport leases are designed to ensure the timeliness of capital improvements and prevent land banking by tenants. In the noted examination, the City executed two lease amendments for additional time to complete construction, however construction was completed before a third amendment could be brought to the Commission. Staff will ensure that any lease amendments are approved by the City Commission.

Finding 6

Finding: It does not appear that all applicable subleases have received pre-approval by the City Commission.

Recommendation:

The City Manager:

- Identify and ratify subtenant leases that did not receive proper Commission approval.
- Design and implement policies and procedures that require adequate documentation and monitoring for subleases to ensure compliance with lease provisions and FAA requirements; and
- Collaborate with the City Attorney's Office for re-designing the lease provision for subleasing to ensure purpose/objective for required approvals is understood; adequate documentation is obtained; and FAA compliance is maintained.

Management Response

An existing provision in each non-aeronautical lease requires the prime tenant to provide notification to the Airport when a subtenant occupies greater than fifty one percent of the overall leasehold which triggers a requirement for City Commission approval. The Airport has two non-aeronautical subtenants that occupy greater than fifty one percent of the

overall leasehold and both have been approve by the City Commission. The Airport will explore modification of lease language to a more administrative process for subtenant approval with the purpose of maintaining FAA compliance. Staff will also review any existing subtenant leases that have not received proper Commission approval and will get these ratified by the City Commission.

Finding 7

Finding: File retention practices should be improved.

Recommendation:

The City Manager:

- Retrain FXE personnel on proper records retention practices and requirements; and
- Develop and implement policies and procedures to adequately maintain files in accordance with records retention requirements and completeness of the lease files.

Management Response

The Division, within the next sixty days, will schedule records retention training with the City Clerk's Office and will continue to coordinate with the City Clerk's Office on file retention efforts and best practices. Additionally, Airport staff will work with the Clerk's staff to develop policies for staff to follow and meet compliance.

Observation 1

Finding: FXE Management did not define a clear fuel flowage revenue calculation lease provision.

Recommendation:

The City Manager have the City Commission determine and approve lease amendments to clarify the fuel flowage calculation basis

Management Response

Fuel flowage lease language and the application of fees has been in place since 1990 however, to ensure clarity, fuel flowage language in each lease has been amended pending approval by the City Commission. Amended leases will be coming forward in a very future meeting. Staff will work to ensure that all lease amendments address clear fuel flowage revenue calculation language and get such amendment approved by the City Commission.

Observation 2

Finding: FXE Management did not verify lessees' self-reported fuel deliveries.

Recommendation:

The City Manager develop and implement policies and procedures for independent verification of lessees' self-reported fuel deliveries and FXE fuel revenues.

Management Response

The Airport has seven fueling agents that receive fuel deliveries. Of those, one receives as many as four fuel deliveries each day. Currently, it is not feasible to observe each fuel delivery by each fueling agent. Additionally, fuel receipts are reconciled by Airport staff monthly. Staff will research the possibility of adopting new technology that may accurately report fuel deliveries and provide real time data.

Observation 3

Finding: Collection of lease rents requires an independent verification control.

Recommendation:

The City Manager designate a financial oriented City department to implement detailed monitoring of airport leases and independent verification of FXE's newly insourced rent adjustment and collection process

Management Response

Collection of rents and fees is an essential business function of the Airport Division. Similar to other City Departments, the Airport issues invoices and collects fees locally. For the period audited, a City contracted third-party was responsible for rent collection which resulted in deficiencies that ultimately lead to lease administration responsibilities returning to the Airport. Staff will research the potential of implementing controls to achieve recommendation of validating rent adjustments and collections.

c: Tarlesha W. Smith, Esq., Assistant City Manager
Susan Grant, Assistant City Manager
Anthony G. Fajardo, Assistant City Manager
Alain E. Boileau, City Attorney
David R. Soloman, City Clerk