# FOLLOW-UP OF

# AVIATION DEPARTMENT CONTRACT ADMINISTRATION

# REPORT NO. 06-01-116F

**City of Albuquerque**
**Office of Internal Audit and Investigations**

*City of Albuquerque*
**Office of Internal Audit and Investigations**
P.O. Box 1293 Albuquerque, New Mexico 87103

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Accountability in Government Oversight Committee
City of Albuquerque
Albuquerque, New Mexico

Follow-Up: AVIATION DEPARTMENT CONTRACT ADMINISTRATION
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**FINAL**

INTRODUCTION

The Office of Internal Audit and Investigations performed a Follow-up of Audit No. 01-116, Aviation Department Contract Administration, issued March 30, 2005. The purpose of our Follow-up is to report on the progress made by Aviation Department (Aviation) management in addressing our findings and recommendations.

At the time of the audit, Aviation had a group of five employees who were responsible for contract administration. As of March 2004, Aviation records indicated that it administered 218 contracts. Aviation had contracts with vendors who supplied goods and or services to the department. Aviation also administered contracts for contractors that paid concession fees, rentals and other fees to the department.

SCOPE, OBJECTIVES, AND METHODOLOGY

Our Follow-up procedures consist of inquires of City Personnel and review and verification of applicable documentation to assess the status of our audit recommendations. Our Follow-up is substantially less in scope than an audit. Our objective is to ensure management has taken meaningful and effective corrective action in regards to our findings and recommendations. The audit was conducted in accordance with Government Auditing Standards, except Standard 3.49, requiring an external quality review.

The scope of the Follow-Up did not include an examination of all the functions and activities related to Aviation. We limited our scope to actions taken to address our audit recommendations from the period of March 30, 2005, to September 12, 2006.

RECOMMENDATION NO. 1:

The Rental Car Shuttle Bus Management and Operation Agreement is a cost reimbursable contract that Aviation has with a vendor to operate a shuttle bus service. This service provides transportation for airline passengers between the terminal and the rental car facility.

The initial budget proposed by the vendor in FY2001 was $1,996,384. This budget increased by 38 percent from FY2002 through FY2004 to $2,761,587. The audit determined that Aviation may not have adequate controls in place to analyze and determine if the increase of costs were necessary. As a result, Aviation paid the contractor $2.9 million versus a budget of $2,761,587 in FY2004.

According to the vendor, the two major cost increases during the period from FY2001 to FY2004 were related to additional payroll costs and a decision by the City to use compressed natural gas (CNG) buses. However, the vendor had based its bid on the use of low-polluting diesel buses.

The audit recommended that Aviation:

- Develop effective controls to analyze and determine if the increase of costs are necessary.
- Analyze the effects on future operating costs prior to making decisions to implement requirements for different technologies, such as the acquisition of CNG buses versus low-polluting diesel buses.
- Ensure that the Contractor does not exceed the approved budget without the prior written consent of the Director.

Aviation agreed to:

- Develop effective controls to analyze the increase of costs.
- Ensure that all contracts exceeding the approved budget will have prior written consent from the Director.

ACTIONS TAKEN

The audit recommendations have been partially implemented. Aviation personnel provided OIAI with spreadsheets prepared by Aviation's Fiscal Officer. The spreadsheets included the vendor's prior years actual and current costs, and next years budget for the vendor. The spreadsheet also included the Fiscal Officer's written analysis. Aviation's Fiscal Officer, Associate Director of Finance, Planning Manager and the Rental Car Shuttle Bus operator met to discuss the proposed 2006 budget and the Fiscal Officer's analysis. However, Aviation personnel informed OIAI that there are no written procedures for the analysis, evaluation and approval of increases in the vendor's budget.

OIAI reviewed the Fiscal Officer's analysis of the vendor's proposed 2006 budget of $3,006,136. The analysis indicated that the budget was too high by $150,000. OIAI was informed that Aviation management subsequently met with the vendor and concluded that the budget was reasonable. Aviation could not provide an explanation as to why the budget was determined reasonable, and could not provide minutes of this meeting.

The first amendment to the Agreement requires that not later than January 1 of each year, the vendor shall submit for approval by the Aviation Director, a proposed operating budget for the following year. Aviation could not provide documentation indicating that the Director approved the 2006 budget.

Beginning in December 2005, the CNG fleet was to be replaced with clean-diesel buses. Although the buses are the property of the vendor, Aviation will pay for the costs of the fleet through its cost reimbursable contract with the vendor. OIAI asked Aviation fiscal personnel if they analyzed the cost/benefit effect on future operating costs of this replacement decision. OIAI was informed that prior Aviation personnel discussed and analyzed the cost/benefit effect, but written documentation to support this decision could not be located.

FOLLOW-UP RECOMMENDATION

Aviation should develop written procedures for the analysis, evaluation and approval of increases in the vendor's budget. If the vendor proposes cost increases, Aviation should determine and document if the increased costs are justified.

When a contract with a vendor requires the approval of a proposed budget by the Aviation Director, the decision should be documented.

If vendors submit proposed budgets that Aviation believes to be excessive, the resolution should be documented.

When Aviation performs an analysis of the cost/benefit effect on future operating costs of equipment replacement, they should document the results of the analysis.

RESPONSE FROM AVIATION

***"Aviation is currently in the process of developing written procedures for the analysis, evaluation and approval of increases in the vendor's budget. These procedures are expected to be complete in December 2006 and will be used to evaluate and analyze the vendor's Fiscal Year 2008 budget. Aviation will also, in the future, document issues related to the vendor's budget."***

RECOMMENDATION NO. 2:

The audit determined that Aviation personnel may not have been thoroughly reviewing the shuttle bus service vendor's invoices prior to payment, to ensure all costs invoiced were in compliance with the terms of the agreement. The vendor invoiced Aviation and was paid for:

- Unallowable travel expenses of $10,907.
- $2,420 of unleaded fuel and $134 of diesel fuel, but only used CNG buses.
- $558 in late payment fees to suppliers.
- $6,814 of vehicle repair costs due to contaminated fuel obtained from the fuel supplier through ABQ Ride. ABQ Ride had obtained the fuel from the local gas and electric utility.
- $25,000 for a refundable deposit required by the vendor's vehicle maintenance subcontractor.

The audit recommended that Aviation:

- Ensure that all cost reimbursements are reviewed for accuracy and contract compliance prior to payment.
- Request repayment from the Contractor for charges that are specifically prohibited by the contract and charges that are not appropriate.
- Ensure that ABQ Ride management was made aware of the contaminated fuel issue.
- Determine if the Contractor should have been reimbursed for the $25,000 deposit.

Aviation agreed to:

- Ensure cost reimbursements are reviewed for accuracy and compliance.

- Take appropriate action to adjust the accounting entries related to deposits paid by sub-contractors.

ACTIONS TAKEN

The audit recommendations have been implemented or resolved. Aviation's Fiscal Officer reviews and inputs all reimbursements into a spreadsheet. Items in question are discussed with the Planning Manager who also reviews budgets and contracts.

Aviation did not implement the recommendation that it request repayment from the Contractor for unallowable travel expenses of $10,907. Aviation's explanation was that:

- It would be difficult to determine at this time which expenses may have been verbally approved, but not documented by former directors.
- It would not be cost effective to expend further time and effort to investigate, and contract specialists are now aware of this issue.

OIAI considers this recommendation resolved. The previous Director's verbal approval would likely prevent the department from collecting a refund.

The recommendation concerning the $25,000 deposit is considered resolved. Aviation provided OIAI documentation indicating refund of the deposit when the maintenance sub-contract expired.

The recommendation that ABQ Ride management should be made aware of the contaminated fuel issue is considered resolved as follows:

- The shuttle bus contractor and Aviation staff met with the fuel supplier to develop a plan to correct the problem.
- New equipment was installed by the fuel supplier to reduce fuel contamination.

RECOMMENDATION NO. 3:

Aviation had a contract with a vendor for the display advertising concession at the airport. The contract expired in August 1997. At the time of the audit, the contract had been expired for six years. However, Aviation continued to do business with this vendor under the terms of the expired contract, on a month-to-month basis. For FY2004, the City received approximately $240,000 in revenue from this concession contract. The City's Public Purchases Ordinance (5-5-19) states "The following purchases must be approved by the City Council: . . . Concession contracts expected to generate revenues to the City in excess of $55,000 over a 12-month period. The Mayor shall provide the expected contract amount of all contracts submitted to Council for approval and of any requested extensions of these contracts."

In April 1972, the City entered into a contract with a Contractor who provided in-flight catering services for airlines. During 2002, the Contractor paid the City $164,000 relating to this contract. Although the contract expired in October of 1997, Aviation continued to do business with this Contractor under the terms of the expired contract, on a month-to-month basis.

The Aviation manager responsible for contract administration stated that he was aware the contracts had expired. He stated that Aviation did not have a process to monitor the expiration date of contracts, and to ensure that contracts were either renewed or put out to bid when they expired.

The contract with the in-flight catering services vendor stated that the term Gross Receipts meant the price actually charged for all food, beverages, merchandise sold and all services performed; whether collected or not. In January 2002, the vendor deducted $13,000 of uncollectible credit sales from its calculation of the commission due on gross sales, which was not in compliance with the contract terms.

The audit recommended that Aviation should:

- Develop and implement a process to ensure that it has current contracts with all vendors and lessees.
- Request the City Purchasing Division to either renegotiate the contract, or prepare a Request for Bids to result in the issuance of a new contract, upon expiration.
- Obtain the required City Council approval if a concession contract is expected to generate more that $55,000 a year. Additionally, Aviation should ensure that the in-flight catering services vendor pays commissions on all sales, as required by the contract.

Aviation agreed to:

- Involve the Purchasing Division when a contract needs to be negotiated, or issue a Request for Bids.
- Obtain the approval from City Council involving all contracts that generate more than $55,000 a year.
- Ensure that vendors pay commissions on all sales as required by the contract.

ACTIONS TAKEN

The audit recommendations have been partially implemented. The department has implemented the Airport Management System/Airport Business Manager computer software. This software notifies the Contract Manager and the Contract Specialists of upcoming expiration dates/events of general agreements, provisions, insurance, bonds, etc. OIAI reviewed Aviation's use of this software, and determined that the contract administration process has improved.

Aviation has replaced the expired display advertising contract with a new contract. Aviation provided OIAI documentation indicating approval of the new contract by City Council.

OIAI examined the new contract and related correspondence/documentation and noted that in April 2006, the Aviation Department Planning Manager authorized the vendor to withhold \$9,488 from contract payments to the City. This was done to reimburse the vendor for changes that Aviation requested to certain display advertising fixtures that had been installed by the vendor. There are no provisions in the contract allowing Aviation personnel to authorize the vendor to withhold monies from contract payments to the City. The withholding of \$9,488 from contract payments to the City is not in accordance with Generally Accepted Accounting Principals (GAAP) as required by the New Mexico State Auditor's Rule, §2.2.2.10 NMAC. The revenue was not recorded, thus understating Aviation revenue; and the \$9,488 expenditure was not recorded as a City expense or fixed asset. Additionally, Aviation procured goods using a concession contract, thereby circumventing the procurement procedures outlined in the City's Purchasing Rules and Regulations.

Aviation did not bill the in-flight catering services vendor for the commission due to the City on the \$13,000 of uncollectible sales, until June 2006, after the follow-up inquired about the status of this item.

FOLLOW-UP RECOMMENDATION

Aviation should not authorize the withholding of funds from contract payments to pay expenditures due from vendors. This practice is not in accordance with GAAP. Aviation should account for all concessionaire contract revenue.

RESPONSE FROM AVIATION

***"Aviation will propose a City adjustment to properly record concessionaire contract revenue of $9,488 in Fiscal Year 2006. The Aviation Department has amended the concessionaire contract to include a provision for the reimbursement of costs incurred by the contractor to accommodate the City's requests for modifications."***

RECOMMENDATION NO. 4:

The audit determined that Aviation was not receiving financial statements from vendors that were required by the contract. The Department was not following up when the required financial statements were not received. For example, Aviation personnel informed us that even though the original ground lease for the airport hotel required annual reports, this provision was not enforced for several years. They stated that the requirement was overlooked when the owners of the hotel changed.

The City's contract required a gift shop concessionaire to provide Aviation with a statement of its gross revenues and the percentages due to the City for each calendar year. The contract requires the statements to be audited by the vendor's Certified Public Accountants. The statements provided were not audited.

The contract with the in-flight catering services vendor requires certified revenue statements. As of April 2003, the vendor had not provided the required certified statement for calendar year 2001.

The audit determined that Aviation contract management personnel were not familiar with the terms and conditions of the contracts administered, and were not taking action to ensure that the vendors complied with all terms.

The audit recommended that:

- Aviation enforce contract terms requiring vendors to provide annual statements that certify all required fees have been paid to the City.
- References in contracts clearly identify whether the required financial statements should be audited, compiled or reviewed by Certified Public Accountants.
- Aviation follow up when the required financial statements have not been received.

Aviation responded that it implemented a property management system that has the ability to track due dates for annual reports for concession agreements. Aviation developed a policy to send out reminder notices at least sixty days prior to the due date to concessionaires who are required to submit an annual report. Aviation agreed to implement a procedure and designate staff members as points of contact for the submittal of Annual Reports.

ACTIONS TAKEN

The audit recommendations have been partially implemented. Aviation has implemented a process whereby vendor's annual reports are reviewed by Aviation's principal auditor to determine compliance with the contract. As part of our follow-up test procedures, we examined the annual revenue statements for 2004 and 2005 which the operator of the airport hotel provided to Aviation. These annual revenue statements were labeled as unaudited. This does not comply with the City's lease with the airport hotel operator, which states, "Lessee shall also furnish the City annually, covering each annual rental period hereunder, an annual statement, covering all business transacted by Lessee upon which the City is entitled to a percentage rent as provided herein, . . . All annual statements shall be certified by Lessee's firm of certified public accountants, which firm shall be nationally recognized."

Aviation informed OIAI that as contracts expire and new contracts are negotiated and signed, an Annual Reporting clause will be required stating a certified audited Statement of Gross Revenues must be submitted at year-end.

Aviation has implemented an updated contract administration/tracking software system that tracks due dates for annual reports for concession agreements. Aviation notifies the vendors prior to the due dates of the annual reports. OIAI examined a recent system report which indicated upcoming due dates for annual reports for concession agreements. OIAI verified that that Aviation prepared notices to send to the vendors reminding them of the upcoming due dates.

FOLLOW-UP RECOMMENDATION

Aviation should require the airport hotel operator to comply with the contractual requirement to provide the City with an annual statement certified by a nationally recognized firm of Certified Public Accountants.

RESPONSE FROM AVIATION

***"The airport hotel operator will be providing the required annual statement certified by Deloitte & Touche LLP."***

RECOMMENDATION NO. 5:

The audit determined that Aviation contract administrators were not thoroughly familiar with all of the terms and conditions of the contracts that they managed. This could cause disputes with vendors and a loss of revenue to the City. For example, the operator of the airport hotel had not correctly calculated the minimum rent which was due to the City. The operator was paying Aviation a lower amount than the minimum rent required by the contract. The Aviation contract administrator who managed this contract was not thoroughly familiar with the terms and conditions of the contract that specified the calculation of minimum rent.

Aviation had gift shop concession contracts with three different vendors. Each of these concession contracts required an annual report detailing operational expenditures. The Aviation contract administrator stated that the department never required any of the three vendors to comply with this contractual requirement, although the contracts were in effect since 1991. The Aviation contract administrator was not aware of the requirement and was not sure of its purpose.

The audit recommended that:

- Aviation ensure that its contract administrators are thoroughly familiar with all of the terms and conditions of the contracts that they manage.
- If Aviation determines that a contract clause is unenforceable, or does not have a purpose, it should work with the vendor to delete the clause.

Aviation responded that it was reorganizing the Contract and Administration section, and committed that the contract specialists would become familiar with all terms and conditions of contracts administered by the Department. Aviation drafted a new Retail Concession Agreement that eliminated unenforceable contract clauses.

ACTIONS TAKEN

The audit recommendations have been partially implemented. The Aviation Contract Manager notified the Contract Specialists, in writing, that they must be thoroughly familiar with the terms and conditions of the contracts, and ensure that contractors comply with the requirements. According to the Aviation Contract Manager, as of September 2006, there were 230 contracts to administer. However, as of September 2006, the two Contract Specialist positions have been vacant for six months. The department is in the process of interviewing candidates for those positions.

FOLLOW-UP RECOMMENDATION

Aviation should ensure that the new Contract Specialists receive contract administration training. Aviation should also ensure that the Contract Specialists thoroughly familiarize themselves with the terms and conditions of the contracts that they administer.

RESPONSE FROM AVIATION

***"When the new contract specialists are hired, the contract manager will work with the specialists to ensure they are trained and are familiar with the terms and conditions of the contracts they will be administering."***

RECOMMENDATION NO. 6:

Aviation built a new rental car facility, which opened in March 2001. In May 2000, Aviation sent a letter to all rental car companies, which stated, "Tenant shall file for a permanent closure of their fueling facility with the UST Bureau of NMED and remove and properly dispose of all above and underground storage tanks. Tenant shall be responsible for remediation of contamination, if any, as a result of their fueling operations, and shall provide Aviation with a report certifying that the site is free of hazardous materials." NMED is the New Mexico Environmental Department.

Aviation could not provide OIAI copies of the reports certifying that the underground fuel storage tank sites were free of hazardous materials (certifications). Underground fuel storage tanks can cause significant environmental problems, if leaks occur.

The audit recommended that Aviation obtain certifications.

Aviation agreed to obtain certifications, or to certify the sites themselves through other scheduled projects.

ACTIONS TAKEN

The audit recommendation has been fully implemented. Aviation provided OIAI copies of documentation indicating that the three rental car companies' underground fuel storage tanks had been removed and the sites were free of hazardous materials. However, Aviation had not obtained documentation that one of these three sites was free of hazardous materials, until October 2006, after the follow-up had inquired about the status.

RECOMMENDATION NO. 7:

The 1980 agreement with the major tenant in the general aviation area of the airport states that the rent payable shall be increased or decreased beginning with the lease year commencing on December 1, 1985, and thereafter, on the 1st day of each third year. The increase or decrease shall be based on a determination of the actual operating costs for the South General Aviation Area.

The audit determined that Aviation never adjusted the rent in the 22-year period that the contract was in effect. According to a November 1999 Aviation Department memorandum, a cost center for the South General Aviation Area was not established to enable the department to determine actual operating costs. Consequently, the department did not have the information necessary to determine if actual operating costs had increased, which would support changes in the rent costs. The tenant was still paying a rental rate that was established 22 years ago.

This Federal Aviation Administration (FAA) also identified this issue in an audit report in 1998. The FAA indicated that these findings required action, and stated that adjustments to aeronautical lease rates should be based on a recognized economic index. This was not done by Aviation.

The tenant is also in the business of selling aviation fuel and lubricants. The 1980 agreement required the tenant to pay Aviation a commission on the sale of these products. In 1989, the commission fee on each gallon of aviation fuel was raised. The fee has not been raised since. The commission fee on lubricants has never been raised.

The audit recommended that Aviation

- Adjust the General Aviation tenant's contract escalation provision based on a recognized economic index, as recommended by the FAA.
- Consider raising the commission fees on aviation fuel and lubricants.

Aviation responded that a FY2006 $9.1 million capital improvement project to rebuild the Fixed Base Operator (FBO) aircraft parking ramp areas was planned. The FBOs would be required to fund a portion of the project. The FBOs would also be required to enter into negotiations with the Department to modify certain portions of their existing Agreements. The modifications would reflect current market rentals rates, additional reporting requirements and escalation provisions.

ACTIONS TAKEN

The audit recommendations have been partially implemented. In March 2006, Aviation personnel met with representatives of the major tenant in the general aviation area of the airport. OIAI was informed that the parties reached an initial understanding that Aviation needs to replace the General Aviation ramp and that as a concession to the City, the major tenant was willing to renegotiate provisions within their lease. According to Aviation, this tenant's lease with El Paso International Airport took into account current market conditions for General Aviation Industry, and Aviation personnel reviewed this lease as a foundation for a new agreement. As of September 2006, Aviation has not yet finalized a new agreement with the tenant.

FOLLOW-UP RECOMMENDATION

Aviation should ensure that the new agreement is finalized with the tenant and that it compensates the City in accordance with current market conditions. The agreement should include provisions to increase compensation in future years based on a recognized economic index, as recommended by the FAA.

RESPONSE FROM AVIATION

***"Negotiations with the tenant are on going. The start and completion of the ramp replacement project (a capital improvement project) is a key element in the negotiations with the tenant. Funding for this project is part of the Federal Aviation Administration's (FAA) Fiscal Year 2008 budget. The new agreement, when finalized, will include the provision to increase compensation in future years based on a recognized economic index as recommended by the FAA."***

## CONCLUSION

Two audit recommendations have been fully implemented. Five audit recommendations have been partially implemented. As noted in our follow-up recommendations, Aviation needs to further strengthen its internal policies and procedures as it pertains to contract administration.

We appreciate the assistance and cooperation of Aviation personnel during the audit.

__________________________________
Principal Auditor

REVIEWED:

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Audit Manager

| APPROVED: | APPROVED FOR PUBLICATION: |
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| __________________________________ | __________________________________ |
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