Lunken Fuel Flowage Fees Audit

Introduction

At the request of the Department of Transportation and Engineering, the Internal Audit Division (IAD) has conducted an audit of the fuel flowage fees paid by tenants of Lunken Airport to the City to ensure that all taxes are properly accounted for and remitted. Airport tenants currently pay the City $0.12/gallon on fuel they use or purchase. The airport's two Fixed Base Operators (FBOs), which sell fuel to transient aircraft as well as other Lunken tenants, collect $0.12/gallon but remit $0.06/gallon to the City. This policy is regulated by Municipal Code Article 402-23, which states, "every person, firm or corporation receiving or storing gasoline or jet engine fuel at Lunken Airport or Blue Ash Airport shall…pay to the City at the time the statement is rendered the fee of 12 cents per gallon on gasoline or jet engine fuel sold or used; …retailers to the public of fuel under permit of the City (fixed base operators)… shall be permitted to retain a minimum of 6 cents and up to a maximum of 8 cents per gallon of the fee imposed above on gasoline or jet engine fuel sold or used." The fuel fees are a surrogate measure for airport use. These fuel flowage fees generated more than $500,000 in revenue in 2003.

Scope and Methodology

This audit examined the process used to calculate, collect, and monitor fuel flowage fees to determine whether Lunken was being paid the flowage fees it is owed. The audit was also designed to clarify why some airport tenants were remitting their fees via the FBOs, which retained half of the fee, and whether this relationship was appropriate and in accordance with the Municipal Code.

IAD conducted its audit in December 2003 and January 2004, reviewing financial documents and interviewing those individuals involved with flowage calculations. IAD spoke with the Lunken Airport Manager, the two FBOs, and six other airport tenants to determine how flowage fees were calculated and reported. Delivery records from fuel suppliers were compared with reports tenants submitted documenting their fuel usage and appropriate fees for the period April 1998 to April 2004. Full reconciliation of all records was done on six tenants and spot checks were done for two others. Fuel suppliers Air BP and Chevron-Texaco supplied additional delivery information where Lunken records were insufficient. Additional fieldwork was conducted in June 2004 to bring figures up to date for the release of the report.

Findings

Two major conclusions can be reached as a result of this audit:

1. Most tenants are paying the City the correct amount of fuel flowage fees. There are, however, two tenants who pay fees via an FBO, which retains one-half of the revenue even though it plays no role in the fueling process. The practice is not permitted by

the Municipal Code or an official airport policy but is reported to be based on instructions given by the previous Airport Manager in the early 1990s.
2. Lunken lacks sufficient accounting and physical security controls to adequately monitor fuel usage at the airport and the fees owed to it.

1. Flowage fees passing through the FBOs

Lunken's tenants submit fuel flowage fees to the airport on a monthly basis. Eleven operators pay these fees directly to the airport at a rate of $0.12/gallon. Lunken's two FBOs, Midwest Jet Center (Midwest) and Million Air, collect $0.12/gallon on gas that they sell to transient aircraft and other Lunken tenants. The FBOs retain $0.06/gallon of that revenue and remit the other half to the City, per the Municipal Code. In addition to these operations, the FBOs also report fuel flowage for several other tenants. The FBOs remit $0.06/gallon to the City from these operators and retains $0.06/gallon. Midwest reports and remits fuel flowage fees for: Cin-Air, Jet Resource, and UC Aircare. Million Air reports and remits for: Executive Jet Management and OnFlight. The audit found that in the case of Executive Jet Management, On Flight, and UC Aircare, the FBO fuels these carriers as if they were transient planes and passes on $.06/gallon to the City, in accordance with the Municipal Code.

The audit also identified two current tenants who remit their fees through the FBO, which retains one-half of the revenue even though it is not permitted by the Municipal Code. Cin-Air and Jet Resource have their own fuel farms. They order their own fuel, store it at their farm, pump it into their planes, and calculate their own flowage for the month. They then submit their fuel information and fees to Midwest each month. Midwest retains $0.06/gallon for both airlines and remits $0.06/gallon to the City. Aside from minor assistance and occasional fuel swaps of 1000 gallons or less, Midwest does not provide any fuel-related services to either company. Similarly, Procter and Gamble currently pays its flowage fees directly to the City but had been submitting them via Midwest until March 2001.

IAD was unable to locate any written justification for tenants to remit their fuel flowage payments through the FBO when the FBO is not buying or pumping the fuel. There is no policy giving the FBOs the right to half of the flowage fees for fuel it neither purchases nor sells. Lunken Airport has no documentation regarding this practice or its origins, although a few tenants state that it started in 1991. There is no longer anyone at the airport that can confirm this policy existed or its purpose. Neither the FBOs nor the other tenants interviewed have any written documentation about the policy. This practice of passing fees through the FBO can be documented to April 1998, when Lunken began documenting fuel usage and fee reporting. Cin-Air and Jet Resource have paid their $0.12/gallon fees via the FBO at least since April 1998 to the present. Procter and Gamble did the same at least from April 1998 to March 2001, when it began paying the City directly.

Three of the tenants interviewed claimed to have some memory or knowledge of when the policy was created. Cin-Air and Jet Resource representatives said that they have used this payment arrangement for the last ten to twelve years. Jet Resource began paying flowage through the FBO in 1991 when they launched charter operations. A Condor representative said he was approached several times in the 1990s about paying flowage this way, but his organization declined. He was unsure when he first was asked, but posited that it might have been 1995. The financial manager at Procter and Gamble who handled the payment arrangements through Midwest has since retired. No current staff member knows why payments had been made to Midwest for flowage fees or why the company began paying the City directly.

The tenants differed as to whether this practice was permitted as an official airport policy. Cin-Air and Condor believed that there had been an official airport directive that allowed them to do so. Both stated that they received a letter from the previous Airport Manager about this but neither was able to locate it. Jet Resource said that the previous Airport Manager informed them verbally that one of the conditions for operating charter flights from Lunken was to pay flowage through an FBO. He stated that Jet Resource had to approach the FBOs to arrange the procedure because neither FBO was aware of the policy at the time. Because Jet Resource knew that the practice was not officially set out in the Municipal Code, it drafted an agreement between itself and the FBO describing the terms of the arrangement, but that agreement also cannot be found. Condor stated that it had been approached by an FBO several times about entering into a similar arrangement. Condor sought and received permission from the Airport Manager to do this but Condor also wanted a letter from the City Solicitor's office stating that the practice was acceptable. Because they were not given such a letter, Condor chose not to participate, fearing at some point the City would require them to repay the flowage fees they had paid to the FBO.

All three interviewees confirm that the program was designed to assist the FBOs, though there was no agreement about why this assistance was considered necessary. The Jet Resource representative believed the assistance was somehow related to the tenant's right to do charter work. Representatives of both Cin-Air and Jet Resource were under the impression that all charter operators on the field had to pay their flowage fees through an FBO. On the other hand, the Condor representative believed that the policy was designed to help the FBOs because of the large number of independent fuel farms on the field. Because most of the corporate tenants had their own farms, they understood that the FBOs needed help financially. He believed that at one point many of the corporate tenants, including Kroger and Procter and Gamble, had paid fees through the FBOs. He is unsure when or why they stopped, though he speculated that they shared his concern about being held responsible for fees passed through the FBO.

Because of the undocumented and unclear origins of the policy, IAD cannot determine that operators were permitted to pay their flowage through the FBO. Interviews suggest that both tenants and the FBO were acting according to what they believed to be airport policy. The tenants were paying the full fee to the FBO for this entire period but the FBO kept half. Over the course of the six years for which Lunken has records, the FBO retained $288,142.05, which the City would have received if the companies had submitted their flowage fees directly (see Appendix A).

2. Need for accounting and physical security controls on fuel at Lunken

As a result of this audit, IAD has identified several weaknesses in Lunken's ability to monitor fuel use and the fees owed to it. The current security climate associated with air travel also underscores the need for Lunken staff to monitor fuel deliveries to the airport more closely.

The following control weaknesses make it difficult for Lunken to monitor the accuracy of the reports given to it by its tenants:

- Supplier records, which are the only way the airport can independently confirm tenant reports, are often incomplete or not provided in a timely manner. For example, one supplier was providing the records on a yearly basis. Another supplier had been delivering fuel for Executive Jet to Million Air (in violation of co-mingling rules) from May 2002 to April 2003, with no one at the airport aware that this supplier was delivering fuel to the airport.
- No one at Lunken consistently reconciles delivery and tenant reports, creating an opportunity for unreported or underreported fuel deliveries. IAD identified 9 instances where a tenant failed to report and pay fees on fuel even though the supplier had reported the deliveries to Lunken on its monthly statements. These unreported unreconciled deliveries between February 1999 and August 2003 have associated flowage fees of approximately $8,400 (see Appendix B). The reports from six tenants were reconciled with supplier records in the course of this audit, but discrepancies could still exist in the other tenants' unchecked records.
- Lunken faces a significant challenge in reconciling flowage records because suppliers report the amount of fuel delivered whereas many tenants pay based on their usage for the month (as permitted by the Municipal Code). Seven Lunken tenants calculate flowage fees based on what is delivered for the month while twelve others report based on the fuel they load into their airplanes. Because monthly deliveries and usage often vary (for example, when a tenant receives a delivery on the last day of a month and uses the fuel the next month), delivery amounts rarely equal usage in a given month. Lunken has no independent means to verify whether tenant usage reports are accurate. As part of the audit, IAD compared reported usage with delivery information for six tenants. Usage and delivery figures usually differed sharply in any given month but were very similar on a year-on-year basis, differing by only a few percentage points. Nonetheless, given the lack of monitoring by Lunken, there is no check to ensure the accuracy of the reports it is receiving.

Recommendations

The following recommendations are intended to strengthen the controls on fuel usage reporting and fee payment as well as to ensure correct payment for past fuel usage.

1. Stop the practice of FBOs collecting flowage fees on fuel that does not pass through their tanks. All tenants with their own fuel farms should be instructed to pay their

full fuel flowage fees directly to the City, as required by the Municipal Code. This would not require changes to any formal written policies. The average amount retained by the FBO decreased significantly in March 2001 when Procter and Gamble began paying the City directly. Nonetheless, based on 2002 and 2003 averages, ending this practice would generate approximately $20,000 additional annual revenue (see Appendix A).

The Solicitor's Office should determine if there is a legal basis to recoup the $288,142.05 in fees that were paid to the FBO rather than the City between April 1998 and April 2004.

Department Response

a. We have notified Midwest Jet Center, Cin-Air, and Jet Resource to cease this practice (see Appendix C).

b. Regarding the fuel flowage fees collected, this matter has been referred to the City Solicitor's Office. The fees retained by Midwest Jet Center are a complicated issue and will require thoughtful consideration. The Solicitor's Office will be working closely with the Department of Transportation and Engineering to resolve this matter.

2. <u>Recover payments from Cin-Air for unreported deliveries</u>. These deliveries have been documented by the supplier but not reported to the City or paid for by the tenant. A list of these deliveries can be found in Appendix B.

Department Response

The City Solicitor's Office feels there is an adequate basis for recovery from Cin-Air. We will send a letter requesting payment for the unreported deliveries.

3. <u>Remind tenants of their responsibility for flowage fees.</u> The Municipal Code indicates that tenants are responsible for the timely payment of flowage fees for all fuel delivered to their tanks. Tenants should be reminded of this obligation.

Department Response

Once the Cincinnati Municipal Code (CMC) is changed to respond to recommendation #4 (see below), tenants will be notified regarding the change to the CMC. In the future, at the end of each calendar year, tenants will be sent a notice reminding them of their obligation along with a Fuel Flowage Report Form for the upcoming year. A copy of Fuel Flowage Form can be found in Appendix C.

4. <u>Require flowage to be calculated on a delivery basis</u>. Reconciliation for Lunken is difficult in part because of the difference between supplier delivery records and tenant

usage reports. The easiest way for Lunken to guarantee that it can independently verify fuel usage would be for it to require all tenants to calculate their flowage based on the amount of fuel delivered. This would require a change to the Municipal Code, which currently allows tenants to calculate fees based on what is sold or used. A Lunken staff member would check the amount reported by the tenant against the fuel supplier's record. All suppliers indicated a willingness to provide monthly records to the airport for this purpose.

From Lunken's point of view, fees for fuel delivered would provide faster and more reliable reconciliation and require far less cumbersome controls than an annual reconciliation of fuel and delivery receipts. Implementing this recommendation would require resolving the following issues:

- The Municipal Code would need to be rewritten so that fuel fees are calculated on a delivery basis.
- A few tenants expressed concern about being required to pay fees on delivered fuel not used for aviation. Some fuel is lost due to shrinkage in cold weather and when fuel lines are cleaned out. The tenants indicated that these losses are usually no larger than one or two hundred gallons per month, making the fees on unused fuel less than $25 per month.
- The FBO that services government aircraft does not collect fees for this fuel. This practice is not supported by the Municipal Code. Because the federal government generally exempts itself from such fees, the Municipal Code would need to be changed so that the FBOs do not need to collect fees for government fuel.
- Some tenants were concerned that they would be paying fuel fees in advance for fuel they had not used. For example, they would pay fees on an end of the month delivery that they would not use until the following month. However, when considered on an annual basis, delivery and usage figures tend to even out and the total amount paid should be the same.
- Tenants currently using usage-based calculations would need to pay fees on their current inventory as part of the transition to delivery-based calculations. For an FBO with three 12,000-gallon tanks, the maximum cost of this one-time charge could be as high as $2,160.

Department Response

The Aviation Division supports this recommendation and has requested the City Solicitor's Office to make a change to the Cincinnati Municipal Code, Airport Section 402, to reflect this practice.

5. <u>Conduct monthly or annual flowage reconciliations</u>. A Lunken staff member should receive and reconcile fuel delivery reports from suppliers and tenants every month. Such reconciliation would allow the staff to identify any deliveries that were unreported or underreported. To ensure that Lunken has records from all fuel suppliers servicing the airport, it should send a letter each year to all local aviation fuel suppliers requiring them to submit monthly records if they make deliveries to the airport.

Department Response

Lunken staff will reconcile fuel reports from suppliers and tenants every month. Area aviation fuel suppliers will be sent a letter informing them of the requirement to submit monthly records of deliveries to Lunken annually.

6. Review security measures for fuel delivery and storage. In light of the general security climate and concerns about airport safety, Lunken should review policies and practices at the airport to ensure that fuel sites are adequately protected.

Department Response

Lunken staff has instituted some improvements to security by changes such as the installation of the perimeter fence and gate project, reducing access by the public. The individual tenants control access to their fuel farms. Staff monitors compliance with daily checks of all gates to ensure closure. The fuel farms also have locking mechanisms that must be in place when the farm is unattended. Compliance is ensured through spot checks by Airport staff, the Fire Department, and the BUSTR compliance officer. Lunken staff will continue to monitor security and institute improvements as needed.