

# OFFICE OF THE STATE INSPECTOR GENERAL

## Virginia Department of Aviation Peninsula Airport Commission Oversight

May 22, 2017



Michael C. Westfall, CPA  
Acting State Inspector General  
Report No. 2017-PR-011



**COMMONWEALTH OF VIRGINIA**  
**Office of the State Inspector General**

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May 22, 2017

Governor Terrence R. McAuliffe  
PO Box 1475  
Richmond, VA 23219

Dear Governor McAuliffe,

The Office of the State Inspector General (OSIG) has completed an audit of the Virginia Department of Aviation (DOAV) and the final report is attached.

OSIG would like to thank DOAV Executive Director Randall Burdette and his staff for their cooperation and assistance during this audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael C. Westfall".

Michael C. Westfall, CPA  
Acting State Inspector General

CC: Paul Reagan, Chief of Staff to Governor McAuliffe  
Suzette P. Denslow, Deputy Chief of Staff to Governor McAuliffe  
Aubrey L. Layne, Jr., Secretary of Transportation  
Senator Charles W. Carrico, Sr., Chairman of the Transportation Committee  
Delegate Ronald Villanueva, Chairman of the Transportation Committee  
Roderick D. Hall, Chairman of the Virginia Aviation Board  
Randall Burdette, Executive Director of the Virginia Department of Aviation

## HIGHLIGHTS

# Virginia Department of Aviation - Peninsula Airport Commission Oversight

## *What OSIG Found*

### **Lack of Financial Reviews of Airport Sponsors**

Through a review of the Peninsula Airport Commission's (PAC) audited financial statements from 2010 – 2015 and Entitlement Utilization Reports from FY2011 – FY2016, the following was noted:

- In its 2014 audited financial statement, PAC identified it had guaranteed a \$5 million line of credit loan for People Express, Inc. (PEX) in June 2014;
- The 2014 financial statement did not indicate what PAC funds would cover this expense if PEX defaulted on the loan;
- PAC utilized state entitlement funds to pay \$3.55 million (over 75%) of the loan to the lending financial institution in 2015, with remaining funds derived from federal grants and donated funds;
- The 2015 audited financial statements did not record a receivable balance for the loan payment and did not indicate plans to seek reimbursement of the payment from PEX;
- The Entitlement Utilization Report for 2015 did not identify the \$3.55 million as a loan pay off, but posted it as an air service development project; and
- PAC's 2015 Entitlement Utilization Report was not filed with the Department of Aviation (DOAV) until October 2016. It would have been due on July 30, 2015 if they had requested discretionary funds.

### **Need for Strengthened Master Agreements between Airport Sponsors and DOAV**

DOAV has executed master agreements with airport sponsors, which set restrictions on state grant or allocation funding received by the sponsor. The master agreements are not strong enough to enforce compliance with state funding requirements.

Management concurred with 19 of 19 recommendations and plans to implement corrective actions from May 2017 to February 2018.

### **Why OSIG Conducted This Audit**

In January 2017, DOAV became aware of potential misappropriation of state funds by an airport sponsor. Based on this potential misappropriation, and at the request of the Secretary of Transportation, OSIG conducted an audit of DOAV procedures regarding oversight of state funded programs.

### **What OSIG Recommends**

- DOAV should require audited financial statements and Entitlement Utilization Reports be submitted annually to DOAV by established deadlines.
- DOAV should review the audited financial statements and Entitlement Utilization Reports to assist in identifying potential financial issues and ensure state funds are being handled in accordance with regulations and procedures.
- DOAV should strengthen its master agreements with sponsors to include statements related to allowable costs; litigation protection; accounting system oversight; recordkeeping, report and inspection requirements; the right-to-audit clause; and the right to amend/withdraw grants.



For more information, please contact OSIG at (804) 625-3255 or [www.osig.virginia.gov](http://www.osig.virginia.gov)

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## BACKGROUND

The Virginia Department of Aviation (DOAV) is a state transportation agency whose mission is to cultivate an advanced aviation system that is safe, secure and provides for economic development; promotes aviation awareness and education; and provides the safest and most efficient flight services for Commonwealth leadership and state agencies.

The Virginia Aviation Board (VAB) is a political subdivision of the Commonwealth consisting of eight members appointed by the Governor and confirmed by the General Assembly. Functions of the Board include publicizing and monitoring DOAV policies and programs; promulgating regulations necessary to promote and develop safe aviation practices; establishing financial assistance programs; and allocating funds for capital improvement projects.

The Airport Program Manual has been created to document the requirements of programs managed by the DOAV. According to the DOAV Airport Program Manual (Program Manual), “the Commonwealth of Virginia maintains one of the nation’s most comprehensive and advanced statewide aviation systems.” To support the continuing growth and operation of this system, the VAB has developed funding programs to assist Airport Sponsors (sponsors) of public-use airports with a variety of improvement activities ranging from planning to construction to promotions. The funding programs are:

- Airport Capital Program
- Facilities and Equipment Program
- Voluntary Security Program
- Maintenance Program
- Aviation Promotion Program
- Air Service Development and Enhancement Program

For each of these programs, DOAV provides financial and technical assistance to eligible airport sponsors for the planning, development, promotion, construction and operation of airports and aviation facilities. The Program Manual provides information on what projects are eligible for funding, percentage of state participation, and the process for obtaining funding from submission of the project request to receiving the reimbursement.

There are three classifications for airports that receive these funds:

- Air Carrier Airports Entitlement Funds
- Air Carrier/Reliever Discretionary Funds
- General Aviation Discretionary Funds

From the Transportation Trust Fund, DOAV receives approximately \$24 million annually (2.4% of the Transportation Trust Fund), which is disbursed to airports through either of the above three

methods. According to Code of Virginia § [58.1-638](#), the following is a breakdown of these disbursements:

- 40% (Entitlement Funds) of these funds are allocated to air carrier airports, based upon percentage of enplanements, of which no air carrier airport shall receive less than \$50,000 nor more than \$2 million annually;
- 40% (Discretionary Funds) shall be allocated to the VAB for air carrier and reliever airports; and
- 20% (Discretionary Funds) shall be allocated by the VAB for general aviation airports.

Entitlement funds are disbursed three times a year to the individual airports (September, December and March). Discretionary funds are project based. Airports must submit project requests through an IQ Portal with detailed information regarding the projects and must be approved through the VAB. Funding is then allocated and the sponsors' disbursements are reimbursed after invoices and all related documents have been reviewed by DOAV staff.

According to the Program Manual, "it is the expressed intent of the VAB that an air carrier airport sponsor totally obligates its state entitlement funds prior to that sponsor receiving any state discretionary fund allocations. These funds include unexpended state entitlement funds from previous fiscal years, interest earned on state entitlement funds, and passenger facility charges used to reimburse state entitlement fund accounts." Sponsors determine the expenditure of state entitlement funds; however, it is the VAB's intent that these funds be used as the state's share of costs for eligible federally funded projects.

State entitlement funds can be used for any project eligible under the Airport Capital Program, Facilities and Equipment Program and Maintenance Program. Operational costs are not eligible under any state funding program. According to the Program Manual, "certain projects have been determined to be eligible only for the expenditure of state entitlement funds, referred to as entitlement only projects. Projects that are eligible only for state entitlement funds include, but are not limited to:

- Debt service retirement;
- Aircraft removal systems;
- Construction of Aircraft Rescue and Firefighting (ARFF) simulator facilities and the provision of their related equipment, such as simulator pad, airfield access, and propane;
- Maintenance contracts and repairs related to systems and equipment;
- Purchase of equipment for snow or ice removal and treatment that exceeds a snow removal equipment plan for a Federal Airport Regulation (FAR) Part 139 airport;
- Purchase of firearms and body armor for law enforcement officers employed by the airport;
- Procurement of equipment, videos, and consultant services used to meet FAR Part 139 and TSAR 1542 (airport security) training requirements; and

- Improvements and training needed for Occupational Safety and Health Administration (OSHA) compliance.

Projects that are not listed have been determined to be outside of normal project expenditures. If the sponsors of an air carrier airport use state entitlement funds for such a project, the state's share of the project cost will be counted against new requests for state discretionary funding. Projects will be retained in the accounting until they are deducted from a state discretionary project request or they have been on record for six fiscal years, at which time the project will be removed from the accounting.

Projects that are considered outside of normal project expenditures include, but are not limited to:

- Aviation promotion projects;
- Air service development projects;
- Landside passenger shuttles;
- Recurring operational costs; and
- Airport personnel salaries and benefits.

Per the Program Manual, "air carrier airports may use their state entitlement funds to cover 100 percent of the non-federal share of federal projects. This provision applies only to federally funded projects where state entitlement funds will be used solely to fund the entire non-federal amount. When an airport sponsor or project is not eligible for federal funds or federal funds are not available, state entitlement funds may be used for the state funded projects. For most state funded projects, state entitlement funds may be used for a maximum of 80 percent of eligible project costs.

There are 66 public use airports in the Virginia Air Transportation System. Nine of the 66 are commercial service airports. Seven commercial service airports and Metropolitan Washington Airports Authority (MWAA) are eligible for entitlement funds. The balance (57 airports) are considered general aviation airports and are eligible for state discretionary funding.

In January 2017, OSIG was asked by the Secretary of Transportation to conduct a review of DOAV based on a complaint that had been received alleging that the Peninsula Airport Commission (PAC) had misappropriated state entitlement funds. PAC guaranteed a loan for a private airline, People Express, Inc. (PEX), that defaulted on the loan requiring PAC to pay the loan in full to the financial institution. Based on this request OSIG initiated a review of DOAV's processes and procedures regarding the handling of projects within each funding program specific to PAC, but also reviewed other airport sponsors as well to ensure funding for each program was being utilized in accordance with regulations. Separately, the Virginia Department of Transportation (VDOT) was engaged to conduct an investigation into PAC's finances and handling of the agreements between PAC and PEX.

## SCOPE

The scope of this audit is specific to funds transferred from DOAV to PAC for Capital Projects authorized by DOAV and paid for by the Capital Airport Fund. Projects funded from July 1, 2012 through March 31, 2017 are included. This timeframe is intended to capture the funds the state paid to PAC and PAC paid to a private bank as a guarantor on the loan. The state portion of the \$4.5 million loan payment was more than \$3.55 million.

## OBJECTIVES

Objectives of this audit were:

- Determine whether funding programs (Airport Capital, Facilities & Equipment, Voluntary Security, Maintenance, Aviation Promotion, Air Service Development and Enhancement) processes are in place to ensure recipients (specifically PAC) are properly utilizing funds in accordance with regulations.
- Evaluate the financial statement/external audit review process within DOAV to ensure information is being reviewed properly to identify any potential discrepancies of state fund usage.

## METHODOLOGY

OSIG conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that OSIG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. OSIG believes that the evidence obtained provides a reasonable basis for the findings and conclusion based on the audit objectives.

OSIG applied various methodologies during the audit process to gather and analyze information pertinent to the audit scope and to assist with developing and testing the audit objectives. The methodologies included the following:

- Conducting interviews and observations/walk-throughs;
- Examining policies and procedures to gain an understanding of the audit area;
- Assessing the processes for efficiency and effectiveness;
- Collecting and analyzing relevant data; and
- Researching processes regarding master agreements between airport sponsors and the Federal Aviation Administration (FAA).



## FINDINGS

### *Perform Financial Reviews of Airport Sponsors*

State entitlement funds are allocated annually to sponsors of airports that have scheduled air carrier service in accordance with Code of Virginia § 58.1-638.43. The amount allocated to each airport is calculated on the basis of the previous calendar year's enplaned passengers at the airport as a percentage of the total enplaned passengers in the Commonwealth. Entitlement funds may be used for 100% of the non-federal portion of projects that are funded under provisions of the Federal Airport Improvement Program and for various projects not funded by the Federal Airport Improvement Program. DOAV has provided PAC with approximately \$2 million in state entitlement funds annually since 2013.

According to DOAV, the only financial report obtained from airport sponsors is the Entitlement Utilization Report, which provides an annual accounting of the previous fiscal year's state entitlement fund expenditures. The Entitlement Utilization Report, from the airport sponsors, is required annually according to the Program Manual paragraph 2.4.5. Air Carrier Airports cannot get discretionary funds if they do not have a VAB approved Entitlement Utilization Report for the prior fiscal year. DOAV does not require a copy of the airport sponsor's annual audited financial statements.

OSIG obtained copies of PAC's 2010 – 2015 audited financial statements from the Virginia Resources Authority, and FY2011 – FY2016 Entitlement Utilization Reports from DOAV. This was done to show that if DOAV had received the financial statements along with the Entitlement Utilization Reports, it would have assisted in identifying state funds that were potentially misused to guarantee a loan for a private airline, and to determine if anything was noted on the Entitlement Utilization Report related to a loan guarantee. PAC submitted the annual Entitlement Utilization Reports to DOAV as required by the Program Manual even though they did not use discretionary funds during this time period.

Through a review of the audited financial statements the following was noted:

- In its 2014 audited financial statement, PAC identified it had guaranteed a \$5 million line of credit loan for People Express, Inc. (PEX) in June 2014;
- The report did not indicate what PAC funds would cover this expense if PEX defaulted on the loan;
- PAC utilized state entitlement funds to pay \$3.55 million (over 75%) of the loan to the lending financial institution in 2015, with remaining funds derived from federal grants and donated funds;
- The 2015 audited financial statements did not appear to record a receivable balance for the loan payment and did not indicate plans to seek reimbursement of the payment from PEX;

- The Entitlement Utilization Report for 2015 did not identify the \$3.55 million as a loan pay off, but posted it as an air service development project; and
- PAC's 2015 Entitlement Utilization Report was not filed with the Department of Aviation (DOAV) until October 2016. It would have been due on July 30, 2015 if they had requested discretionary funds.

DOAV does not request copies of annual audited financial statements from airport commissions. It only reviews the Entitlement Utilization Reports, which are required to be turned in by airport sponsors if they intend to request discretionary funds to be utilized for projects.

Obtaining copies of airport audited financial statements would provide more detailed information to DOAV to ensure state funds provided are being utilized for their intended purpose and are in accordance with regulations and policies. Had DOAV obtained these reports from PAC, they would have been aware of the \$5 million loan guarantee for People Express, Inc. (PEX) in 2014.

#### **Recommendation(s):**

1. DOAV should require that audited financial statements and Entitlement Utilization Reports be submitted annually to DOAV by established deadlines.
2. DOAV should develop a policy and related procedures to follow up on audited financial statements and Entitlement Utilization Reports not submitted in a timely manner. Consider potential repercussions if sponsors do not meet submission deadlines.
3. DOAV should review the audited financial statements and Entitlement Utilization Reports to assist in identifying potential financial issues and ensure state funds are being handled in accordance with regulations and procedures.
4. DOAV should develop procedures to require additional documentation from both the airport sponsor and their financial statement auditors to support the use of state funds by airport sponsors.
5. DOAV should incorporate this requirement into their master agreements and Airport Program Manual.

#### ***Management Response(s):***

DOAV **agrees** with the conditions observed and the recommendations as presented with the following statement:

DOAV agrees with the recommendations concerning the performance of financial reviews of airport sponsors if deemed financially and operationally feasible.

#### ***Corrective Action(s):***

Responsible Position: Cliff Burnette, Director ASD

Estimated Completion Date: February 2018

1. Amend policy to include the requirement of audited financial statements in the Airport Program Manual (APM) revision.
2. Amend policy to establish ramifications for sponsors not adhering to submission deadlines for entitlement utilization reports and audited financial statements as noted in Corrective Action #1 for inclusion in the APM Revision.
3. Establish policy for internal review of submitted audited financial statements and entitlement utilization reports to be included in the APM revision.
4. Amend Chapter 3.0 of the APM to include the requirement of additional documentation from airport sponsors and/or their financial statement auditors to verify the proper use of state funds for eligible projects to be included in the APM revision.
5. Revise Airport Master Agreement (AMA) and APM to include recommendations 1-4 above.

### ***Strengthen the Master Agreements between Airport Sponsors and Department of Aviation***

Per the Program Manual 3.4.1:

“The master agreement on terms and conditions for accepting state aviation funding resources contains the terms and conditions for accepting state aviation funding from the Commonwealth of Virginia for capital, facilities and equipment, security, maintenance, aviation promotion and air service development projects. These terms and conditions identify sponsor responsibilities during and after the implementation of a project. The terms and conditions apply to funding awarded under grants and allocations.

The master agreement contains general conditions, such as obtaining goods and services in accordance with the Virginia Public Procurement Act. The master agreement also contains special conditions for land acquisition, public-use spaces and areas, bridge loans, facilities and equipment, and private ownership. If the specifics of a project generate the need for terms and conditions not provided in the master agreement, those terms and conditions will be stated in the grant agreement for the project. The Virginia Aviation Board and DOAV reserve the right to establish additional terms and conditions as needed in accordance with the preamble to the master agreement.

“An executed master agreement must be on file with DOAV in order for a sponsor to receive a grant or an allocation.”

The FAA developed a master agreement on terms and conditions of accepting airport improvement program grants. This master agreement is initiated each time sponsors accept a grant offer from the FAA with its terms and conditions. The master agreement provides detailed information regarding definitions, general conditions, assurances, and the sponsors’ acceptances with these terms.

DOAV has executed master agreements with sponsors, which set the restrictions on state grant or allocation funding received by the sponsor. The master agreements are not strong enough to enforce compliance with state funding requirements and are missing the following key elements that are included within the FAA master agreements:

1. The allowable costs of the project shall not include any costs determined to be ineligible by DOAV, including allocated state funding and grant restrictions.
2. DOAV shall reserve the right to amend or withdraw a grant offer at any time prior to its acceptance by the sponsor.
3. The sponsor shall take all steps, including litigation if necessary, to recover funds spent fraudulently, wastefully or in violation of the Code of Virginia, or misused in any manner in any project upon which funds have been expended.
4. DOAV shall reserve the right to audit the records of sponsors’ vendors who received state or federal funds, and to oversee the accounting system, audit, and recordkeeping requirements.
5. DOAV maintains the right to oversee report and inspections requirements.

Sponsors already sign master agreements with the FAA when sponsors accept grant offers that include similar terms and provide a consistent level of expectations for management of both state and federal funds.

According to the Director of Airport Services, DOAV designed its master agreement in 2010 based on the FAA master agreement, but deleted assurances that they concluded did not apply to DOAV. The master agreement was reviewed by the Attorney General’s Office at that time, but the potential issues identified with the use of State Entitlement Funds with a specific airport sponsor have made clear stronger master agreements are necessary to protect state funds.

Weak master agreements with airport sponsors prevent a consistent level of expectations for management of state funds and could result in airport sponsors using state funds for ineligible projects.

**Recommendation(s):**

6. DOAV should strengthen its master agreements with sponsors to include statements related to allowable costs, litigation protection; accounting system oversight; recordkeeping, report and inspection requirements; the right to audit clause; and the right to amend/withdraw grants.
7. Once master agreements are modified, DOAV should have all airports sign the new agreements and then resign in the future upon changes of personnel or when other conditions have changed that would warrant a resigning of the document.

**Management Response(s):**

DOAV agrees with the conditions observed and the recommendations as presented.

**Corrective Action(s)**

Responsible Position: Cliff Burnette, Director ASD

Estimated Completion Date: February 2018

6. Revise AMA with airport sponsors to include all items listed in recommendation 6. Amend APM Section 3.4.1 to include the items listed in recommendation 6.
7. Develop an internal process to require all airport sponsors to execute an AMA within 90 days of required approval. Amend APM Section 3.4.1 to require that a new agreement be signed when sponsor management changes. Revise AMA and APM. Require 65 airport sponsors to execute revised AMA.

***Strengthen Controls over State Funding Usage and Entitlement Utilization Report Reviews***

According to the Program Manual 4.0, “In order to receive state entitlement funds, the sponsors of an air carrier airport must provide DOAV with a one-time certification to ensure that the sponsor:

- Is eligible for state entitlement funds
- Will spend state entitlement funds in accordance with Code of Virginia § [5.1-2.16](#).”

Entitlement Utilization Reports are required to be filed with DOAV per the Program Manual paragraph 2.4.5. If airport sponsors want to receive state discretionary funds for a project, they must have the prior fiscal year Entitlement Utilization Report filed and approved by the VAB. Both the Entitlement Utilization Report and the request for state discretionary funds must be approved by the VAB. This report must account for the expenditure of state entitlement funds,

including accrued interest, and be filed within 30 calendar days after the close of the fiscal year (July 30th).

DOAV's controls over state entitlement funds to airport sponsors vary significantly compared to the controls over state discretionary funds. The Code of Virginia has provided DOAV with significantly stronger oversight and decision making related to issuance and control of discretionary funds versus entitlement funds.

Based on allegations that the PAC potentially utilized state entitlement funds for an inappropriate/ineligible project, the PAC's FY11 – FY16 Entitlement Utilization Reports were reviewed with the following results:

- Five of six (83 percent) of the reports were not reviewed by DOAV and certified by the airport sponsors in a timely manner;
- Twelve projects identified on the reports were completed within one fiscal year and were not identified as an ongoing/future project on the previous year's utilization report;
- Fifteen projects identified on the reports from 2011 - 2016 were marked as future/ongoing for several fiscal years;
- FY15 and FY16 reports were obtained in October 2016, but were not reviewed by DOAV staff until January 2017;
- Entitlement Utilization Reports are reviewed and approved by the VAB, but the Board's approval is not communicated back to the airport sponsors; and
- Per the Director of Airport Services, DOAV has informally extended the time to submit Entitlement Utilization Reports to September 16<sup>th</sup> of each year. This was verbally communicated to the airport sponsors, but the Program Manual was not updated to reflect this change and according to the DOAV Executive Director this is/was not an approved change because it would not be in time to approve a request for discretionary funding.

PAC reported \$4 million of funding for an air service development project on their FY15 report, which was not received until October 2016. This delay is significant because the \$4 million air service development project was the loan repayment made by PAC with state funds but not reported to DOAV for more than a year. Staff reviewed the report in January 2017 and reached out to PAC to obtain further details on this project. PAC made DOAV aware at that time that the funds were utilized as a loan guarantee for People Express, Inc. which is an ineligible project. Unfortunately, DOAV lacks the internal authority to require the funds to be reimbursed to the state for inappropriate use.

The FY14 Entitlement Utilization Report from PAC did not identify the financial guarantee PAC had with People Express, Inc., obligating entitlement funds to this potential air service

development project. PAC had already guaranteed the loan at the time the FY14 Entitlement Utilization Report was issued.

Per the Director of Airport Services, airport sponsors often complete projects that were not originally planned due to unforeseen operational and maintenance requirements, federal, state and local requirements and funds.

DOAV does not have a process in place to ensure the proper use of state entitlement funds provided to airport sponsors in accordance with Code of Virginia § 5.1-2.16. The only oversight DOAV currently has for state entitlement funds are the annual Entitlement Utilization Reports, which airport sponsors are not required to submit. Per the Director of Airport Services, since July 2013, DOAV has sent letters to each airport sponsor notifying them of the July 15<sup>th</sup> and September 15<sup>th</sup> Entitlement Utilization Report submission requirements. When DOAV obtains Entitlement Utilization Reports from the airport sponsors, the information in those reports is not fully utilized as follows:

- DOAV does not monitor, review and track ongoing/future projects.
- DOAV does not require repayment by airport sponsors for improper use of entitlement funds when identified, due to lack of authority.

DOAV will deny future use of discretionary funds for up to six years if airport sponsors improperly spend entitlement funds. This does not impact airport sponsors that have no plans to request discretionary funds and increases the risk that state funds will be spent for ineligible projects.

A bill (SB1417) was submitted to the General Assembly in 2017 that would give DOAV more authority over state entitlement funds. This bill would alter the Code of Virginia and require full utilization of the reports to include the tracking and approval of all projects (completed, pending, ongoing and future). Any violations of fund expenditures or failure to report entitlement fund usage or commitments would allow the VAB the authority to withhold entitlement funds. This bill also includes verbiage to prevent airports from utilizing entitlement funds for purposes of supporting operations of an airline through grants, credit enhancements or other related means unless approved by the VAB. This bill has been approved by the House of Delegates and the Senate, and is waiting the Governor's approval. The Governor approved this bill March 24, 2017.

**Recommendation(s):**

8. DOAV should review Entitlement Utilization Reports in a timely manner to ensure entitlement funds are being used in accordance with VAB eligibility criteria and prepare recommendations for VAB.

9. DOAV needs to ensure that all Entitlement Utilization Reports that are approved by the VAB are communicated back to the airports to ensure projects are handled in accordance with VAB approval.
10. New changes to the Code of Virginia will need to be updated in the Program Manual. Training should be provided to airport sponsors to ensure they are knowledgeable of Program Manual requirements and updates.
11. DOAV should determine appropriate timing for filing the Entitlement Utilization Report and update the Program Manual accordingly.

***Management Response(s):***

DOAV **agrees** with the conditions observed and the recommendations as presented with the following statement:

The DOAV and Virginia Aviation Board (VAB) are in a challenging position, as they distribute the Entitlement Fund portion of the Commonwealth Airport Fund with no oversight authority of Entitlement Funds expressed in Virginia Code. Code of Virginia 58.1-638 A 3 a, states, *“Forty percent of the funds shall be allocated to air carrier airports, except airports owned or leased by MWAA, based upon the percentage of enplanements for each airport to total enplanements at all air carrier airports, except airports owned or leased by MWAA. No air carrier airport sponsor, however, shall receive less than \$50,000 nor more than \$2 million per year from this provision.”*

The VAB policy documented in the Program Manual (APM) section 2.4.5 requires the annual submission of an Entitlement Utilization Report to ensure the Air Carrier Airports spend their entitlement funds on eligible, high-priority projects. There is no additional state law or regulation that gives DOAV/VAB any discretion of how to distribute entitlement funding. The only tool DOAV/VAB has to enforce the reporting of the Entitlement Utilization Report is that the VAB will deny future discretionary funding. New legislation passed in the 2017 General Assembly fixes this problem and gives the VAB additional responsibility and authority over the disbursement of entitlement funds. Proposed projects will now be reviewed and approved prior to the disbursement of funds.

On the observation “Entitlement Utilization Reports are reviewed and approved by the VAB, but the Board’s approval is not communicated back to the Airport sponsors” DOAV does record VAB action in board minutes and they are posted on Town Hall for all airports and citizens to access. DOAV will include the Entitlement Utilization Report action on the funding memorandum that goes out after the VAB meeting to the airports requesting funds.



On the observation “DOAV does not monitor, review, and track ongoing/future projects.” DOAV does review Entitlement Utilization Reports on ongoing/future projects working with the sponsor until all the projects are eligible, then we recommend approval to the VAB. This process needs formalization and documentation and we will formalize this process.

***Corrective Action(s)***

Responsible Position: Cliff Burnette, Director ASD

Estimated Completion Date: February 2018

8. Establish internal procedures for timely review of entitlement utilization reports to ensure project eligibility and recommendations to the VAB for project approval. Revise AMA and APM.
9. Modify internal procedures to add formal notification in addition to the current memo and minutes to communicate project approval/denial to airport sponsors. Revise APM to reflect procedure changes.
10. Revise AMA and APM & Provide training to airport sponsors.
11. Develop appropriate policies and procedures for filing entitlement utilization reports and incorporate changes in the APM.

***Conduct Audits of Airport Sponsors***

According to the Program Manual 3.1, “The Commonwealth Airport Fund and the Aviation Special Fund provide the financial resources for the programs established and administered by VAB and DOAV. DOAV may conduct an audit on an airport sponsor’s use of state entitlement and discretionary funds to support accountability monitoring.” Results of these audits are to be reported to the VAB for appropriate action.

The following was identified based on DOAV staff interviews:

- DOAV has no records of any audits and staff cannot recall any audits being conducted of airport sponsors.
- DOAV does not have staff skilled in auditing to actually conduct this type of engagement.
- DOAV does not have a process in place for performing an audit of airport sponsor records.
- DOAV reviews information received regarding projects specific to the aviation special fund and discretionary fund projects, as these are reimbursement-based projects that require supporting documentation. Entitlement funds do not require supporting documentation to be submitted to DOAV.

The master agreement that DOAV utilizes does not include an audit clause. According to the Director of Airport Services, DOAV does not have the staff to conduct the audits as stated in the Program Manual. In order to conduct these audits, DOAV would currently have to hire a third party. DOAV would like to have a compliance/quality control function within DOAV that would require auditing skills to examine quality control/compliance within DOAV, and also conduct performance audits to ensure sponsor compliance.

Without conducting audits of sponsors to ensure state funding is being utilized in accordance with regulations and procedures, state funds are at risk for inappropriate use on ineligible projects.

Establishing a right-to-audit clause within the master agreements would give DOAV the ability to proactively identify high-risk business partners and improve grant compliance.

**Recommendation(s):**

12. DOAV should implement a right-to-audit clause in the master agreements with all airport sponsors to ensure DOAV has the right to review documents necessary to ensure compliance with regulations, to identify risk areas, and to work with airports to strengthen controls.
13. In addition to the right-to-audit clause, DOAV should include language to ensure that airport sponsors are required to correct issues identified in DOAV audits or risk future state funding.
14. DOAV should coordinate efforts with VDOT Internal Audit to develop risk factors along with processes for performing audits.
15. DOAV should pursue resources to conduct audits of airport sponsors either through hiring qualified staff or utilizing available state contracts.

***Management Response(s):***

DOAV **agrees** with the conditions observed and the recommendations as presented, with the following statement:

12. Agreed, DOAV has the right to audit as part of State Policy and the VAB Policy as reflected in the Program Manual. Adding it to the Master Agreements is another good reminder.
13. Agreed.
15. Agreed. DOAV will pursue a LOA with VDOT for audit services to be available for a fee, when needed.

***Corrective Action(s)***

Responsible Position: Cliff Burnette, Director ASD

Estimated Completion Date: February 2018

12. Incorporate recommended audit clause (#12) in the AMA and APM.
13. Incorporate recommended audit clause (#13) in the APM and AMA.
14. Request assistance from VDOT Assurance and Compliance Office to develop risk factors along with process for performing audits.
15. Evaluate available funding and establish an MOA with VDOT for auditing services as needed.

### ***Strengthen the Program Compliance Process***

The Commonwealth Airport Fund (CAF) and the Aviation Special Fund (ASF) provide the financial resources for the programs established and for DOAV.

The Code of Virginia specifies that CAF resources shall be allocated to airports on the basis of their service role as identified in the Virginia Air Transportation System Plan (VATSP). Entitlement and discretionary funds are made available from the CAF, and are used under the Airport Capital Program.

ASF is used for facilities and equipment, general aviation security, maintenance, aviation promotion and air service development programs.

DOAV’s Program Manual states, “for each of these programs, the Airport Program Manual provides information on eligible projects, state participation, and processes from project request submission to reimbursement.” In addition to program information, the Program Manual contains policies of the VAB and the administrative processes DOAV uses to implement policy. The Program Manual does not address every situation or concern faced by airport sponsors. Sponsors should contact DOAV if they have questions on policies and processes not found in the Program Manual.

Sixty-three projects were sampled across the different programs available through DOAV. The following is a breakdown of the individual programs, number of projects tested, and total sample project funding:

Program Type	# of Projects Tested	Total Project Funding
Aviation Promotion	6	\$140,000
Air Service Development Enhancement	9	\$158,992

Facility and Equipment	6	\$67,594
Maintenance	32	\$216,191
Voluntary Security	5	\$309,588
Capital Airport Funds	5	\$719,166
Total Tested	63	\$1,610,531

OSIG reviewed the above projects to ensure they were in accordance with the requirements of the Program Manual. The following was identified during this review:

- For 22 of 27 projects (81 percent) that had grant agreements, the written grant closure notifications were not processed in a timely manner (between two to 12 months late).
- For one of the six Aviation Promotion Program projects tested, DOAV reimbursed the PAC \$15,000 for a project that was ineligible under the program requirements because it promoted a privately owned business, PEX, as sole beneficiary of a promotional effort. In addition, DOAV did not obtain supporting documents from the airport sponsor prior to processing the reimbursement to ensure funds were utilized for promotional efforts.

According to the Public Relations, FOIA & Grants Administrator, grant closure notifications had not been processed in a timely manner due to staff workload volumes. DOAV didn't identify that the reimbursement of the \$15,000 grant to PAC was promoting a privately owned business. In addition, DOAV does not have a quality assurance process in place to review project files and verify that projects were completed in accordance with program requirements.

Reimbursing and accepting project grants without proper supporting documentation puts state funds at risk of being utilized for ineligible projects.

Lack of providing written grant closure notifications to sponsors is in violation of the same program requirements, and would result in both DOAV and the airport sponsors continued tracking and oversight of closed projects.

**Recommendation(s):**

16. DOAV should implement a quality assurance process to conduct periodic reviews of a sample of projects to ensure compliance with the Program Manual.
17. DOAV should ensure that grant closures are conducted in accordance with the policies and procedures outlined in the Program Manual.
18. DOAV should obtain copies of all supporting documentation prior to project acceptance and reimbursements being issued to airport sponsors to ensure compliance.

***Management Response(s):***

DOAV agrees with the conditions observed and the recommendations as presented with the following statement:

DOAV concurs with the recommendations to strengthen the compliance process if deemed financially and operationally feasible.

***Corrective Action(s)***

Responsible Position: Cliff Burnette, Director ASD

Estimated Completion Date: February 2018

16. Include periodic audits of projects as part of the Internal Audit Committee's current audit requirements to ensure compliance with APM and AMA.
17. Enforce close-out process as cited in APM. Revise APM and provide training to DOAV staff. Verify compliance as recommended in quality assurance audits in recommendation #16.
18. Enforce internal procedures to ensure required documentation is received with grant request. Develop and provide recurrent training to staff.

***Require additional Insurance Coverage to Ensure Protection of State Funds***

Per the Program Manual 2.4.3, “Each year a sponsor must certify to DOAV that the sponsor has adequate liability insurance or other means of financial responsibility to satisfy the minimum dollar amount required by *Code of Virginia § 5.1-88.7 et seq.* Per the *Code of Virginia § 5.1-88.8* insurance for bodily injury and property damage liability insurance which provides coverage with respect to each airport or landing area in the amount of one million dollars covering bodily injury and property damage liability in any one accident, constituted proof of financial responsibility.”

DOAV does not require airport sponsors to obtain additional insurance coverage that could be obtained to protect the Commonwealth from any potentially inappropriate usage of state funds, including Faithful Performance of Duty Bond and Blanket/Fidelity/Crime Bonds. The Commonwealth of Virginia requires these bonds for state and local employees handling funds or having access to funds.

Faithful Performance of Duty Bond provides surety for employees handling funds or having access to the funds.

Blanket/Fidelity/Crime Bond protects against loss due to employee dishonesty.

At this time no additional insurance requirements are mandated by the Program Manual or Code of Virginia § 5.1-88.8 by airport sponsors.

Obtaining additional insurance such as the Faithful Performance of Duty Bond and the Blanket/Fidelity/Crime Bond could protect state funds and the airport commissions.

**Recommendation(s):**

19. DOAV should ensure state funds are properly insured by airport sponsors to provide DOAV with additional avenues for obtaining repayment of inappropriately used state funds. This can be accomplished by requiring airports to obtain Faithful Performance of Duty Bonds and Blanket/Fidelity/Crime Bonds for the members of the commissions and executive team employees at airports. This may require an amendment to Code of Virginia § 5.1-88.8, since at this time the code only requires the bodily injury and property damage liability coverage.

***Management Response(s):***

DOAV **agrees** with the conditions observed and the recommendations as presented with the following statement:

Director of Aviation spoke with the Risk Management representative in Treasury, Ms. Joyce Lee, and she supports the recommendation.

Director of Aviation needs to speak with their representative in the Office of the Attorney General, Mr. Jeff Allen, to see if the Virginia Code will need to be changed to accommodate this change or if a Virginia Aviation Board (VAB) policy change is sufficient.

Director of Aviation will also have to research the cost of such insurance to the airports to ensure they understand the full impact of such a requirement.

Director of Aviation and Jeff Allen will present the information to the VAB to determine the appropriate course of action to ensure the Commonwealth's funds are appropriately protected.

***Corrective Action(s)***

Responsible Position: Cliff Burnette, Director ASD

Estimated Completion Date: February 2018

19. Investigate options available and best practices used by other state agencies that provide financial aid to localities.

## AUDIT RESULTS

Based on the results and findings of the audit test work conducted for DOAV, OSIG concluded that internal controls need strengthening in several areas related to DOAV oversight of the airport funding programs as identified in the report findings.