METROPOLITAN AIRPORTS COMMISSION

SELECTED SCOPE FINANCIAL AUDIT

FOR THE YEAR ENDED DECEMBER 31, 1993

NOVEMBER 1994

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

94-54

Centennial Office Building, Saint Paul, MN 55155 ● 612/296-4708

STATE OF MINNESOTA
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Richard Braun, Chair
Metropolitan Airports Commission

Members of the Metropolitan Airports Commission

Mr. Jeffrey Hamiel, Executive Director
Metropolitan Airports Commission

Audit Scope

We have completed a financial related audit of certain financial activities of the Metropolitan Airports Commission as of and for the year ended December 31, 1993. We emphasize that this has not been a complete audit of all programs of the Metropolitan Airports Commission, and that our audit was limited to only that portion of the financial operations as outlined below and as further discussed in the Introduction.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we consider the internal control structure in order to plan our audit of the selected programs, and that we perform tests of the commission's compliance with certain material provisions of laws, regulations, contracts and grants. However, our objective was not to provide an opinion on the internal control structure or on overall compliance with finance-related legal provisions.

Work of Other Auditors

The Metropolitan Airports Commission contracted with a certified public accounting firm to conduct a financial statement audit of the Commission's financial activity for the year ending December 31, 1993. The firm issued an unqualified audit opinion. We reviewed the auditor's work papers and relied on their work, where appropriate, in determining the extent of our testing.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- Reserved retained earnings
- Passenger facility charges

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation and we assessed control risk.

Management Responsibilities

The management of the Metropolitan Airports Commission is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;

- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and

- transactions are recorded properly on the Metropolitan Airports Commission's accounting system in accordance with applicable policies and procedures.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusions

MAC has a complex set of financial statements. It is particularly difficult to understand the components of its fund equity, and the relationship between contributed capital and reserved and unreserved retained earnings. MAC's total fund equity at December 31, 1993 was $393 million.

MAC has made an annual transfer of excess operating funds to its Special Construction Account for several years. However, the Commission has not formally restricted those funds for construction projects. The restriction of assets should be a deliberative process. It is important that MAC restrict its assets for specific purposes and formally identify the reasons for the restrictions.

Passenger Facility Charges (PFCs) provide a new revenue source from which MAC may finance FAA approved construction projects. PFC revenue replaces direct federal grants to an extent. MAC properly accounts for both its PFC revenue and its federal grants. However, because of a difference in accounting principles, PFC revenue has a markedly different effect on MAC's financial statements than direct federal grants.

This report is intended for the information of the Legislative Audit Commission and management of the Metropolitan Airports Commission. This restriction is not intended to limit the distribution of this report, which was released as a public document on November 4, 1994.

We thank the Metropolitan Airports Commission staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: June 17, 1994

Report Signed On: October 27, 1994

Table of Contents

Page

Chapter 1. Introduction	1
Chapter 2. Reserved Retained Earnings	4
Chapter 3. Passenger Facility Charges	7
Agency Response	9

Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
Thomas Donahue, CPA	Audit Manager
Charlie Gill	Auditor-in-Charge
Joan Haskin, CPA	Audit Staff

Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Metropolitan Airports Commission on October 19, 1994:

Jeffrey Hamiel	Executive Director
Denise Kautzer	Director of Finance

Chapter 1. Introduction

The Legislature created the Metropolitan Airports Commission (MAC) as a public corporation in 1943 to develop and operate regional airport facilities. The Commission is organized, structured and administered as provided in Minn. Stat. Sections 473.601 to 473.679. The Commission consists of 15 commissioners. The Governor appoints eight commissioners from designated districts within the metropolitan area and four commissioners representing the greater Minnesota area. The mayors of Saint Paul and Minneapolis also have seats on the commission. The Governor appointed Mr. Hugh Schilling as chair on January 23, 1991. Mr. Schilling served until September 18, 1993 when the Governor appointed the current chair Mr. Richard Braun. The commissioners have the responsibility to establish policies appropriate for MAC to fulfill its statutory responsibilities.

MAC owns and operates seven airports in the metropolitan area, including Minneapolis-St. Paul International Airport which serves as the primary air carrier facility. The following reliever airports that serve general aviation are located in: St. Paul Downtown, Flying Cloud, Crystal, Anoka County/Blaine, Lake Elmo, and Airlake.

MAC finances its day to day operations entirely from user fees that are established for various services and facilities provided at Commission airports. The formulas for the rates (landing fee, ramp fee, terminal rates and off-airport noise surcharge) are established in the current airline use agreement. MAC sets its rates and charges to assure that total system revenues will be sufficient to pay total system expenses. MAC's capital projects are financed either through General Obligation Revenue Bonds, state or federal grants, internally generated funds from operations or Passenger Facility Charges.

The following Table 1-1 summarizes MAC's Statements of Revenues and Expenses and Changes in Retained Earnings for the years ended December 31, 1992 and 1993.

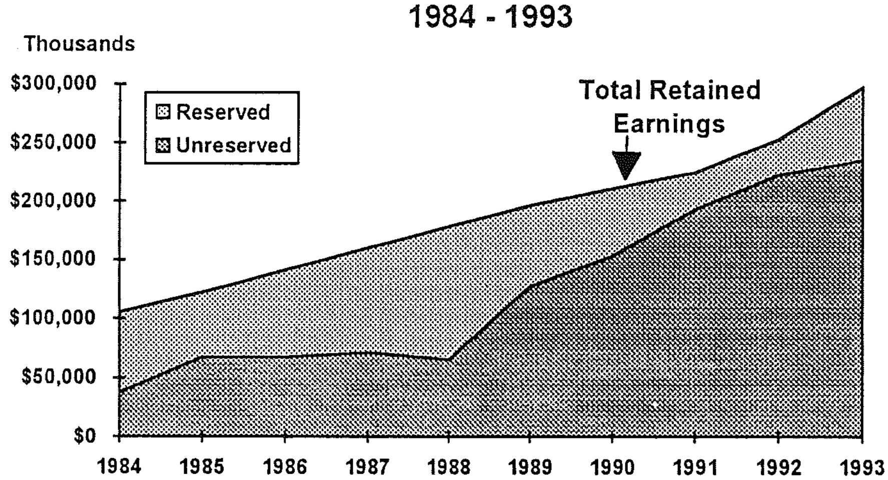
Table 1-1: Statements of Revenues and Expenses and Changes in Retained Earnings (in thousands)

	Years Ended December 31	
	1992	1993
Total Operating Revenues	$65,347	$71,129
Total Operating Expenses	63,427	66,488
Operating Income	1,920	4,641
Other Revenues (Expenses):		
Interest Income	34,238	40,572
Passenger Facility Charge Revenue	14,607	28,596
Bond Interest Expense	(27,544)	(34,812)
Net Income	23,221	38,997
Add: Depreciation of facilities provided by government grants	4,984	5,328
Increase in Retained Earnings	28,205	44,325
Retained Earnings--Beginning of Year	224,596	252,801
Retained Earnings - End of Year	$252,801	$297,126

Source: MAC Comprehensive Annual Financial Report for the year ended December 31, 1993.

Total MAC retained earnings increased 17.5 percent between 1992 and 1993, to a total of $297 million as of December 31, 1993. Retained earnings for MAC have steadily increased over the last ten years. Figure 1-1 shows the increase and the composition of MAC retained earnings for the last ten years. Much of MAC's unreserved retained earnings are not liquid assets. Rather, they represent retained earnings growth from additions in long-term assets, such as airport facilities and lease receivables from the airlines.

Figure 1-1: Retained Earnings 1984 - 1993



Source: Adapted from MAC Comprehensive Annual Financial Reports.

MAC's reserved and unreserved retained earnings at December 31, 1993 were $62.1 million and $235 million, respectively. Table 1-2 shows the specific components of MAC retained earnings and fund equity for fiscal year 1992 and 1993.

Table 1-2: Components of Fund Equity 1992 and 1993 (in thousands)

	December 31 1992	December 31 1993
Restricted Assets:		
Cash and Investments		
Debt Service	$ 72,586	$ 70,749
Construction:		
Regular	12,158	24,730
Special	20,029	40,460
Other	1,124	1,368
Passenger facility charges receivable	3,163	2,377
Total Restricted Assets	$109,060	$139,684
Less payables to be paid from restricted cash and investments:		
Debt Service	72,586	70,749
Construction	4,816	5,481
Other	1,122	1,365
Total Payable from Restricted Assets	78,524	77,595
Total Reserved Retained Earnings	$ 30,536	$ 62,089
Total Unreserved Retained Earnings	222,265	235,037
Total Contributed Capital	91,974	96,060
Total Fund Equity	$344,775	$393,186

Source: Adapted from MAC 1993 Comprehensive Annual Financial Report.

The regular construction funds of $24.7 million for 1993 may include amounts received from the issuance of Commission bonds, government grants, Passenger Facility Charges (PFCs), and interest earned from the investment of such funds. PFCs account for $19.1 million or 77 percent of regular construction funds. These funds are used primarily for construction projects at Minneapolis-St. Paul International Airport.

Special construction funds shown as $40.4 million for 1993 are from residual net income, which the Commission designates as restricted for use at secondary airports or additional Minneapolis-St. Paul International Airport projects.

Our review focused on MAC's reserved and unreserved retained earnings. We evaluated the composition of its reserved retained earnings for future debt service and construction. This included the Special Construction Account and PFCs, as further discussed in Chapters 2 and 3, respectively.

Chapter 2 - Reserved Retained Earnings

Chapter Conclusions

MAC has made an annual transfer of excess operating funds to its Special Construction Account for several years. However, the Commission has not formally restricted those funds for construction projects. The restriction of assets should be a deliberative process. It is important that MAC restrict its assets for specific purposes and formally identify the reasons for the restrictions.

For budgeting purposes, MAC accounts for its operations in three distinct funds: the Operating Fund, the Construction Fund, and the Debt Redemption Fund. The Operating Fund accounts for the general operations of MAC. The major sources of revenue for the Operating Fund are landing fees, space rentals, and concession fees. MAC pays its general operating costs, including salaries and employee benefits, administrative supplies and expenses, professional services, utilities, and maintenance from the Operating Fund. Pursuant to Minn. Stat. Section 473.667 Subd. 4, each year by October 10, MAC transfers sufficient funds from the Operating Fund to the Debt Redemption Fund to provide 27 months of principal and interest payments on outstanding debt. On its balance sheet, monies in the Debt Redemption Fund are shown as restricted assets, which are offset by an equal liability. Thus, there is no effect on retained earnings. MAC also attempts to maintain a balance of $16 million, or approximately four months of working capital, within the Operating Fund. These assets are unrestricted and are a part of unreserved retained earnings. At the end of each year, MAC transfers any residual net income from the Operating Fund to the Construction Fund's Special Construction Account.

1. **MAC automatically transfers residual funds from its Operating Fund to the Special Construction Account. The balance in the Special Construction Fund is shown as reserved retained earnings, but may be used for other purposes at the discretion of the Commission.**

The Commission does not formally authorize and approve excess funds to be transferred from the Operating Fund to the Special Construction Account. Currently, MAC's operating budget provides that "Any excess dollars over and above...is transferred to the Construction Fund." Although the commissioners approve the operating budget and are aware that a transfer will occur, the actual amount of residual or "excess" funds transferred occurs without Commission action and at the end of the year following the issuance of its operating budget. In addition, MAC considers the excess funds transferred to the Special Construction Account to be part of reserved retained earnings.

MAC has made an annual transfer to the Special Construction Account for several years. Over the last few years these transfers have been substantial. MAC transferred $16 million to the Special Construction Account at the end of 1993.

Table 2-1 shows the actual amounts MAC has transferred to the Special Construction Account in the last three years, compared to budgeted estimates.

Table 2-1
Operating Transfers to Special Construction Account
(in thousands)

	Budgeted Estimate	Actual Transfer	Variance
1991	$15,079	$14,497	(582)
1992	12,456	4,538	(7,918)
1993	10,000	16,034	6,034

Note: 1992 decline due to increased cash flow reserve (now $16 million).
Source: MAC 1992, 1993, and 1994 Operating Budgets.

MAC's total reserved retained earnings for 1993 was $62.1 million. MAC includes the Special Construction Account as part of its reserved retained earnings. As shown in Table 2-2, the Special Construction Account at December 31, 1993 was $37.4 million and represented approximately 60 percent of MAC's reserved retained earnings.

Table 2-2
Components of 1993 Reserved Retained Earnings
(in thousands)

	PFC	Special Construction	Debt Service	Other	Total
Restricted Assets:					
Cash and Investments:					
Construction:					
Regular	$19,150			$5,580	$ 24,730
Special		$40,460			40,460
Other				1,368	1,368
PFC Receivable	2,377				2,377
Debt Service			$70,749		70,749
Total Restricted Assets	$21,527	$40,460	$70,749	$6,948	$139,684
Less Payables:					
Debt Service			$70,749		$ 70,479
Construction:					
Regular	$ 2,400				2,400
Special		$ 3,081			3,081
Other				$1,365	1,365
Total Payables	$ 2,400	$ 3,081	$70,749	$1,365	$ 77,595
Total Reserved Retained Earnings	$19,127	$37,379	$ 0	$5,583	$ 62,089

Source: MAC's 1993 Comprehensive Annual Financial Report.

Generally, restrictions on assets and reserves on retained earnings are for specific amounts to meet specific requirements. External requirements such as bond covenants, the passenger facility charge program, debt service and federal grant requirements identify specific asset restrictions. However, the restriction of assets for the Special Construction Account is an informal MAC restriction. As such, MAC could decide at some future time to use the balance of the Special Construction Account for some other purpose. Indeed, in 1992, MAC provided a $45 million loan to Northwest Airlines out of the Special Construction Account.

The reservation of retained earnings should be a more deliberative process. It is important that if MAC reserves its retained earnings for specific purposes it formally identify the reasons for the reservations.

Recommendation

- *MAC should formally authorize and approve fund transfers from its Operating Fund to the Special Construction Account, restrict those assets for special projects, and identify the reasons for the restrictions.*

Chapter 3 - Passenger Facility Charges

Chapter Conclusions

Passenger Facility Charges (PFCs) provide a new revenue source from which MAC may finance FAA approved construction projects. PFC revenue replaces direct federal grants to an extent. MAC properly accounts for both its PFC revenue and its federal grants. However, because of a difference in accounting principles, PFC revenue has a markedly different effect on MAC's financial statements than direct federal grants.

On June 1, 1992, the Commission began collecting PFCs from the airlines. PFCs are fees imposed on enplaned passengers for the purpose of generating revenue for airport projects that increase capacity, increase safety, or mitigate noise impacts. The fee can be set at $1, $2, or $3 per enplaning, originating and connecting passengers. MAC received approval from the Federal Aviation Administration (FAA) to set the fee at $3 per passenger. The airlines collect $3 per passenger and retain 12 cents per passenger as an administrative charge. The airlines pay the remaining $2.88 per passenger to MAC on a monthly basis. The FAA also approved MAC's application to finance the projects identified in Table 3-1. PFCs to finance these projects will be collected from June 1, 1992 through July 31, 1994.

Table 3-1: FAA Approved Projects
As of December 31, 1993
(in thousands)

	Approved	Expended	Unexpended
Upper Level Roadway	$18,261	$ 1,161	$17,100
Lower Level Roadway	4,051	290	3,761
Ground Transportation Center-East/West	11,655	5,128	6,527
Automated People Movement System	18,991	118	18,873
Skyways/Vertical Circulation Towers	14,271	14,271	0
Taxi way C Reconstruction	988	978	10
	$68,217	$21,946	$46,271

Sources: MAC's 1993 Comprehensive Annual Financial Report.
PFC Project to Date Cumulative Report at December 31, 1993.

As shown in Table 1-1, MAC's PFC revenue was $28.6 million for calendar year 1993 and $14.6 million for June 1 through December 31, 1992. The revenue from this source is restricted for construction projects having FAA approval. For calendar year 1993, PFCs represent approximately $19.1 million or 31 percent of the $62.1 million of reserved retained earnings, as shown in Table 2-2.

MAC properly accounts for both its PFC revenues and its federal grants. However, because of a difference in accounting principles, we also observed, as Table 3-2 indicates, that federal and state grants in aid for construction do not affect MAC's financial statements in the same way that PFCs do.

Table 3-2
PFC Versus Federal Grants
Effect on Equity

Transaction	PFC	Federal Grant
Revenues Collected	• Increase Reserved Retained Earnings	• No Effect
Expenditure on Capital Project	• Decrease Reserved Retained Earnings • Increase Unrestricted Reserved Earnings	• Increase Contributed Capital
Capital Assets Depreciated	• Decrease Unreserved Retained Earnings	• Decrease Contributed Capital

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October 26, 1994

Mr. James R. Nobles
Legislative Auditor
Centennial Building
St. Paul, MN 55155

Dear Mr. Nobles:

We appreciate the opportunity to review and comment on the Legislative Audit Report on the Metropolitan Airports Commission.

The report contains the recommendation that the MAC should formally authorize and approve fund transfers from its Operating Fund to the Special Construction Account, restrict those assets for special projects, and identify the reasons for the restrictions. We agree with your recommendation and will ask our Commission to take formal action to authorize future transfers of funds from the Operating Fund to the Special Construction Fund. To the extent that specific projects can be identified they will be included in the action taken by the Commission, otherwise the funds will be identified for general construction purposes.

The Commission did develop a management policy governing the use of the Special Construction Fund in 1981. This policy was discussed by the Audit and Compliance Committee at a meeting held in April 1982. It is our plan to once again present this policy to the Commission for their review and discussion.

Again, we appreciate the opportunity to comment on the report, and look forward to working with your office in the future.

Sincerely,

Jeffrey W. Hamiel
Executive Director

Denise Kautzer

Denise A. Kautzer
Director of Finance

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