
OFFICE OF THE CITY AUDITOR

FINANCIAL RELATED AND COMPLIANCE AUDIT OF THE REVENUE SHARING AGREEMENT WITH THE CITY OF EULESS

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**March 15, 2002
Report No. 355**

Memorandum



CITY OF DALLAS

March 15, 2002

Honorable Mayor and Members of the City Council
City of Dallas

We have conducted a financial related and compliance audit of the revenue sharing agreement among the Cities of Dallas, Fort Worth, and Euless for calendar years 1998, 1999, and 2000.

In our opinion the City of Euless has complied with the terms of the revenue sharing agreement. *Base year revenues* appear reasonable; however, the documentation to support *base year revenues* was not provided. The amounts allocated to the City of Dallas as *increased revenues* and *additional revenues* for calendar years 1998, 1999, and 2000 are reasonable. However, the determination of ad valorem tax revenues is inconsistent, some rent-a-car companies have not paid motor vehicle taxes, and the scope of Euless' independent audit was limited. Related opportunities for improvement and recommendations are presented in this report.

It is our practice to include management responses immediately following each opportunity for improvement (recommendation) in our reports. Management did not provide responses; therefore, we are issuing this report without management responses.

We appreciate the cooperation shown by City of Dallas, City of Euless, and Dallas/Fort Worth International Airport staff during our examination.

Terry R. Milrany, CPA
Senior Audit Manager
for
Thomas M. Taylor, CPA
City Auditor

c: Teodoro J. Benavides, City Manager

**FINANCIAL RELATED AND COMPLIANCE AUDIT OF THE REVENUE SHARING
AGREEMENT WITH THE CITY OF EULESS**

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INTRODUCTION

Authorization

We have conducted a financial related and compliance audit of the revenue sharing agreement among the Cities of Dallas, Fort Worth, and Euless for the calendar years 1998, 1999, and 2000. This audit was conducted under the authority of Chapter IX, Section 2 of the Dallas City Charter and in accordance with the Annual Audit plan approved by the City Council.

Scope and Methodology

Our audit was conducted in accordance with generally accepted government auditing standards and, accordingly, included tests of the accounting and related records and other audit procedures that we considered necessary in the circumstances.

The objectives of our audit were to determine whether:

- *Base year revenues* were reasonable and the basis for computing *base year revenues* was adequately documented.
- Revenues received from the City of Euless were properly computed and in accordance with the revenue sharing agreement.
- The City of Euless has complied with the terms of the revenue sharing agreement.
- Current controls and processes are adequate to provide periodic updates of business entities operating within the City of Euless' boundaries located at Dallas/Fort Worth International Airport (D/FW).

Our audit included a review of selected revenues received and reported by the City of Euless from January 1998 through December 2000. We also reviewed various other procedures and transactions occurring outside the audit period.

To develop an understanding of relevant internal controls, policies, and procedures, we:

- Reviewed financial records and related reports and performed analysis.
- Reviewed KPMG's Analysis of Revenues Generated and Expenses Incurred by D/FW International Airport report dated October 1996.

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- Reviewed KPMG's D/FW Airport Tax Revenue Analysis report dated September 29, 2000.
- Visited City of Euless and D/FW administrative offices and held discussions with personnel.
- Conducted site visits of City of Euless property locations at D/FW airport.
- Interviewed management and staff regarding internal accounting controls.
- Traced revenues received to the City's RESOURCE accounting system.
- Accessed information on the Internet for various property valuations.
- Contacted the Tarrant County Tax Appraisal District regarding ad valorem taxes.

Overall Conclusion

In our opinion the City of Euless has complied with the terms of the revenue sharing agreement. *Base year revenues* appear reasonable; however, the documentation to support *base year revenues* was not provided. The amounts allocated to the City of Dallas as *increased revenues* and *additional revenues* for calendar years 1998, 1999, and 2000 are reasonable. However, the determination of ad valorem tax revenues is inconsistent, some rent-a-car companies have not paid motor vehicle taxes, and the scope of Euless' independent audit was limited. These concerns are noted and discussed in the *Opportunities for Improvement* section of this report.

Background

When the site for D/FW was selected in the mid-1960s, the land that was to become D/FW was located in unincorporated and undeveloped portions of Dallas and Tarrant Counties. Today, D/FW is one of the greatest economic engines for North Texas and is estimated to produce more than \$11.2 billion annually in economic impact for the North Texas economy. This economic engine was created by an entrepreneurial investment between the Cities of Dallas and Fort Worth when they acquired approximately 18,000 acres of unincorporated land located between Dallas and Fort Worth. Each city invested \$70 million in the mid-1960s for the initial acquisition of the land.

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The Cities of Dallas and Fort Worth jointly own D/FW, which has an eleven-member board comprised of seven members from Dallas and four members from Fort Worth. Members are appointed by their respective city councils.

D/FW has 18,074 acres of property located in the jurisdiction of five cities: Coppell, Euless, Fort Worth, Grapevine, and Irving. The chart below indicates the acreage owned by each respective city.

City	Acreage	Percentage of Total Acreage
Coppell	266	1.47%
Euless	3,196	17.68%
Fort Worth	295	1.63%
Grapevine	7,978	44.14%
Irving	6,339	35.08%
Total	18,074	

Source: D/FW Property Map

The Cities of Dallas and Fort Worth wanted to receive their fair share of taxes generated from activities that occur on D/FW property. In the spirit of regional cooperation, Euless agreed to share revenues generated at D/FW with the Cities of Dallas and Fort Worth.

In 1998, the D/FW Board, in consideration for the encouragement and support of economic development on D/FW property, proposed revenue sharing agreements with cities whose:

- Property is within the boundaries of D/FW.
- Community would benefit from such economic development.

In February 1998, the City of Euless, the City of Dallas, the City of Fort Worth, and the D/FW Board approved an interlocal agreement to share revenues. The agreement is perpetual in nature and can only be terminated by the mutual written agreement of all the parties. Base year for the agreement is calendar year 1996, and *base year revenues* for the agreement are \$778,133.

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In the agreement, the City of Euless agrees to share an amount equal to the *increased revenues* over the *base year revenues* with the Cities of Dallas and Fort Worth as follows:

- Euless – one-third (1/3)
- Dallas and Fort Worth – two-thirds (2/3)
(Split proportionately to ownership interest in D/FW, 63.6% and 36.4%, respectively.)

The revenue sharing agreement specifies that *increased revenues* shall be an amount equal to the sum of the following amounts collected, credited to, and/or received by Euless in any calendar year, which are generated on the property, and which are in excess of *base year revenues*:

- Annual maintenance and operation portion of revenue sharing agreement on real and personal property.
- Sales and use tax revenues (excluding portion for general obligation debt service).
- Utility franchise tax revenues.
- Municipal court revenues.
- Mixed beverage tax revenues.
- All other general revenue tax levies.

In addition to the *increased revenues*, the Cities of Dallas, Fort Worth, and Euless share equally in the *additional revenues* authorized in Chapters 334 and 335 of the Local Government Code. These *additional revenues* are derived from the motor vehicle rental taxes. The consolidated car rental facility is located at the South entrance of D/FW and is within Euless City limits. The 200-acre facility has a 1.5 million square foot parking garage with a capacity to hold 4,500 rental cars.

In the revenue sharing agreement “Property” means that portion of Euless located within the geographical boundaries of the D/FW (which is owned in fee simple by the Board, Dallas, and/or Fort Worth) as it exists to date and/or as it may be changed as permitted by law.

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Accounting for the revenues due to the Cities of Dallas and Fort Worth is on a cash basis. The agreement states that Euless agrees to pay Dallas and Fort Worth their respective shares of *increased revenues* and *additional revenues* attributable to each calendar year by March 31st of the following calendar year, unless otherwise agreed in writing signed by all parties. Additionally, the agreement requires the independent auditor of the City of Euless to verify the amount of *increased revenues* and *additional revenues* generated, with the cost of verification apportioned based on the percentages specified on the previous page.

The information shown in the table below is a summary of *increased* and *additional revenues* for calendar years ended 1998, 1999, and 2000. We audited the revenues reported by the City of Euless and noted no significant exceptions.

SUMMARY OF INCREASED AND ADDITIONAL REVENUES FOR 1998, 1999, AND 2000			
Description	1998	1999	2000
Increased Revenues Sources			
Ad Valorem Taxes	\$33,984	\$25,107	\$118,568
Sales and Use Taxes	\$361,188	\$382,367	\$414,168
Utility Franchise Tax	\$27,322	\$26,673	\$75,031
Mixed Beverage Tax	\$47,289	\$48,167	(\$80,464)
Municipal Court Revenues	<u>\$321,871</u>	<u>\$317,956</u>	<u>\$293,440</u>
Total Increased Revenues	\$791,654	\$800,270	\$820,743
Less: Base Increased Revenues	<u>\$778,133</u>	<u>\$778,133</u>	<u>\$778,133</u>
Increased Revenues To Be Shared	<u>\$13,521</u>	<u>\$22,137</u>	<u>\$42,610</u>
City of Dallas Share of Inc. Revs. - Computed by Auditors	\$5,736	\$9,391	\$18,077
City of Dallas Share of Inc. Revs. - Allocated by City of Euless	<u>\$4,485</u>	<u>\$10,642</u>	<u>\$18,079</u>
Increased Revenues Due to the City of Dallas/(Due to the City of Euless)	<u>\$1,251</u>	<u>(\$1,251)</u>	<u>(\$2)</u>
Additional Revenues-Motor Vehicle Tax	<u>\$-0-</u>	<u>\$-0-</u>	<u>\$7,396,690</u>
City of Dallas Share of Inc. Revs. As Computed by Auditors	\$-0-	\$-0-	\$2,465,563
City of Dallas Share of Inc. Revs. As Computed by City of Euless	\$-0-	\$-0-	\$2,465,563
Additional Revenues Due to the City of Dallas/(Due to the City of Euless)	<u>\$-0-</u>	<u>\$-0-</u>	<u>\$-0-</u>
Total Increased Revenues and Additional Revenues Due to the City of Dallas/(Due to the City of Euless)	<u>\$1,251</u>	<u>(\$1,251)</u>	<u>(\$2)</u>

We determined that the adjustment made to mixed beverage tax in year 2000 was appropriate to reflect overstatements to mixed beverage tax reported during 1998 and 1999. Additionally, the amounts remitted to the City of Dallas as *increased revenues* and *additional revenues* for 1998, 1999, and 2000 were proper.

Financial Related and Compliance Audit of the Revenue Sharing Agreement with the City of Eules

OPPORTUNITIES FOR IMPROVEMENT

We identified certain policies, procedures, and practices that can be improved. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the opportunities for improvement presented in this report may not include all areas where improvements may be needed.

1. The determination of ad valorem tax revenues is not consistent.

The revenue sharing agreement uses the term “ad valorem tax” revenues in two separate places (the definitions of *base year revenues* and *increased revenues*). The separate uses may have different meanings or interpretations of ad valorem tax. The ad valorem property tax rate is composed of two elements: a general fund rate and a debt service rate. Both *base year revenues* and *increased revenues* include ad valorem tax to determine revenues. However, neither determination uses the same interpretation, thus resulting in different amounts.

The documentation to support *base year revenues* has not been provided to the Auditors. However, according to the following excerpt from the revenue sharing agreement, it appears that the ad valorem tax used in *base year revenues* considers the total ad valorem tax rate.

“Base Year Revenues shall be \$778,133, which is the sum of the following amounts:
1) \$531,000, which amount has been determined by the parties hereto as representing the amount of all (i) ad valorem tax revenues for real and personal property, ... received, credited to and/or collected by Eules in the Base Year from the Property, ...”

For the determination of *increased revenues*, the revenue sharing agreement states:

“Increased Revenues shall be an amount equal to the sum of the following amounts collected, credited to and/or received by Eules in any calendar year and which are generated from the Property, and which are in excess of Base Year Revenues; (i) *the annual maintenance and operation portion of the ad valorem tax levy on real property and personal property, i.e. excluding the portion necessary for general obligation debt service, ...*”

In the determination of *increased revenues*, the revenue sharing agreement is specific; the debt service portion of the ad valorem tax rate is excluded.

If the ad valorem tax component is different in the calculation of *base year revenues* compared to the ad valorem tax component used in the computation of *increased revenues*, the outcome of revenues to be shared will also be different.

Financial Related and Compliance Audit of the Revenue Sharing Agreement with the City of Euless

OPPORTUNITIES FOR IMPROVEMENT

We recommend that the Chief Financial Officer:

- Ensure that a consistent definition for ad valorem tax revenues is used in all sections of future agreements.
- Consult with the City Attorney to determine whether the current revenue sharing agreement should be amended to ensure that the determination of ad valorem tax revenues is consistent between *base year revenues* and *increased revenues*.
- Ensure that the stated base year revenues are fully supported and documented for future agreements.

2. Some rent-a-car companies have not paid motor vehicle taxes.

Two rent-a-car companies that operated at D/FW are delinquent in remitting their motor vehicle taxes. From October 2000 to the current time, The DBM Group Inc. (Payless) and Willary Metroplex LP (Thrifty) have not remitted motor vehicle taxes to the State Comptroller's Office. As of March 31, 2001, the following motor vehicle taxes have not been paid.

Rent-A-Car Company	Amount in Arrears for Motor Vehicle Taxes
Payless	\$59,048.41
Thrifty	\$90,848.59
Total Amount in Arrears	\$149,897.00

On September 6, 2001, the D/FW Board terminated the rental car lease agreement with Payless for failure to pay past due rents and fees, in addition to the past due taxes, due to the City of Euless. On October 5, 2001, Payless filed for Chapter 7 Bankruptcy. Currently, D/FW Management is negotiating with the corporate office of Thrifty for the past due amounts, including taxes. As a result of these delinquencies, motor vehicle tax revenues, shared equally between the Cities of Euless, Fort Worth, and Dallas, have not been fully collected.

D/FW constructed a \$140 million car-rental facility on Euless land. The facility began operations February 2000. Effective February 1, 2000, the City of Euless entered into an interlocal agreement with the State Comptroller's Office, whereby the State Comptroller's Office collects motor vehicle taxes on behalf of the City of Euless. The State Comptroller remits the motor vehicle taxes collected monthly to the City of Euless. The interlocal agreement also requires the State Comptroller's Office to provide the City of Euless with monthly cumulative lists of delinquent taxpayers and the amounts owed.

Financial Related and Compliance Audit of the Revenue Sharing Agreement with the City of Eules

OPPORTUNITIES FOR IMPROVEMENT

Sections 78-301 and 78-302 of the Eules Code of Ordinance VIII, Part II, state:

“There is hereby levied and imposed a tax at the rate of five percent on the gross rental of a motor vehicle....The tax imposed under this section must be collected on every rental occurring on or after February 1, 2000. “Every owner of a motor vehicle who enters into a rental of a motor vehicle with any other person shall collect the tax imposed by this article on behalf of the city.”

Additionally, Section 78-303 of the Eules Code of Ordinance Article VIII, Part II, states:

“On or before the last day of each calendar month, every owner of a motor vehicle required to collect the tax imposed by this article shall report and send to the city or its designee the taxes collected on behalf of the city for the preceding calendar month.”

D/FW Management is the primary entity involved in ongoing discussions with Payless and Thrifty regarding these delinquencies. The State Comptroller’s Office is an agent for the City of Eules in collecting and remitting motor vehicle tax collected. However, the City of Eules has the authority to take additional actions against the delinquent rent-a-car companies in an effort to collect the amounts in arrears. However, the allocation of expenses the City of Eules may incur in an attempt to collect current, as well as future delinquent motor vehicle taxes, have not been specifically addressed in the revenue sharing agreement.

We recommend that the Chief Financial Officer request the City of Eules to perform all reasonable collection activities.

3. The scope of the independent auditor’s review was limited.

The City of Eules did not request its independent auditor to conduct a review to verify the amount of *increased revenues* and *additional revenues* as required by the revenue sharing agreement. Section X of the agreement states:

“The amount of Increased Revenues and Additional Revenues generated in subsequent years shall be *verified* by the independent auditor of the City of Eules.”

Financial Related and Compliance Audit of the Revenue Sharing Agreement with the City of Euless

OPPORTUNITIES FOR IMPROVEMENT

We reviewed the independent auditor's report, dated April 12, 2001. The report states:

"We have performed the procedures enumerated below, which were agreed to by the City of Euless, Texas (Euless), solely to assist you with respect to the amount of increased revenues and additional revenues generated in years subsequent to December 31, 1996, of Euless, for the year ended December 21, 2000....

"Our procedures and findings are as follows:

- "1. We verified the mathematical accuracy of the calculation of 'Increased Revenues'...for the year ended December 31, 2000.
- "2. We verified the amount of 'Additional Revenues'...received from the State Comptroller showing the amount of local Motor Vehicle Tax payments made during the year ended December 31, 2000."

The independent auditors conducted an agreed-upon procedures engagement and stated the following:

"We were not engaged to, and did not perform an audit, the objective of which would be the expression of an opinion, on the accounting records. Accordingly we do not express an opinion."

The independent auditor did not verify *increased revenues* as required by the agreement. The independent review only addressed verification of *additional revenues* received from the rental of motor vehicles. Additionally, the independent auditor's report is restrictive since the "report is intended solely for the information and use of the City of Euless, Texas and is not intended to be and should not be used by anyone other than the City of Euless, Texas." The independent auditor's report is therefore limited and does not comply with the requirements of the agreement.

The City of Euless' Director of Finance and the independent auditor concurred with the agreed upon procedures since *additional revenues* comprised in excess of 90% of *increased revenues* and *additional revenues* combined. Additionally, Euless' Director of Finance stated that an audit of *increased revenues* would cost approximately \$25,000, and the cost seemed to outweigh the benefit to be realized from an audit. Furthermore, Euless' Director of Finance expressed concerns regarding the duplication of audit procedures and efforts, which would be deemed necessary if there were multiple audits conducted by an independent auditor, as well as internal audits conducted by the City of Fort Worth and by the City of Dallas.

Financial Related and Compliance Audit of the Revenue Sharing Agreement with the City of Euless

OPPORTUNITIES FOR IMPROVEMENT

The absence of an annual independent verification of *increased revenues* reduces the assurance that the City of Euless has complied with the terms of the agreement and that the City of Dallas has received its proper share of revenues.

We Recommend that the Chief Financial Officer:

- Request the City of Euless to comply with the requirements of the revenue agreement and engage its independent auditor to verify *increased revenues* as well as *additional revenues* for subsequent reporting periods.
- Coordinate internal audit efforts between the Cities of Dallas and Fort Worth.

4. Some information needed to determine *increased revenues* is not readily available.

Some information needed to determine *increased revenues* is not readily available and the process to obtain such information is not clearly established and defined. The City of Euless relies primarily on third parties to provide revenue information generated by businesses operating at D/FW and located within the City of Euless' jurisdiction.

Based on the agreement, increased and *additional revenues* are determined on the amounts actually received by the City of Euless during the calendar year. The process of gathering the information needed to determine *increased* and *additional revenues* requires establishing relationships and obtaining cooperation from various agencies and entities. To implement the revenue sharing agreement, Euless' Director of Finance was creative in developing and establishing procedures to obtain needed information.

For sales and use taxes, the Comptroller of Public Accounts, State of Texas, currently provides separate monthly reports on sales and use tax revenues and mixed beverage tax revenues for those D/FW businesses operating inside Euless city limits. We relied on the monthly reports obtained from the State Comptroller's office to verify these revenues. Additionally, the Comptroller of Public Accounts provides Euless monthly reports on *additional revenues* generated from motor vehicle rentals.

The process for obtaining ad valorem tax revenues is not clearly established or defined, since property taxes assessed in one year may not be paid until the subsequent year(s). The City of Euless has not yet established procedures to request and obtain periodic reports regarding leases or businesses operating within the Euless boundaries at D/FW from the D/FW Real Estate Office. As a result, Euless' request to Tarrant County Tax Appraisal District for property tax amounts received from D/FW entities located inside the Euless' city limits may be incomplete. In the absence of a complete listing of properties, we relied primarily on information from the D/FW Real Estate Office, Euless' Director of Finance, site visits, and the Internet.

OPPORTUNITIES FOR IMPROVEMENT

Except for municipal court fees, the City of Euless does not maintain separate accounting records of revenues generated by businesses operating within the City of Euless' jurisdiction and located at D/FW. Without a separate accounting system for the D/FW entities, it is critical that third parties cooperate and give Euless needed and reliable information.

We recommend that the Chief Financial Officer request Euless' Director of Finance to request the D/FW Real Estate Office to provide periodic reports on leases or businesses operating within the Euless boundaries at D/FW.