
OFFICE OF THE CITY AUDITOR

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

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**March 15, 2002
Report No. 354**

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 Irving for calendar years 1999 and 2000.

The results of our inquiries, examinations, and tests lead us to conclude that *base year revenues* were not reasonably determined, and the documentation of the basis is inadequate. We also conclude that the City of Irving has not complied with the terms of the revenue sharing agreement. 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 and Dallas/Fort Worth International Airport staff during our examination.

Paul T. Garner
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 IRVING**

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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 Irving for calendar years 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:

- The City of Dallas' share of revenues from business activities in the City of Irving at the D/FW International Airport (D/FW) is reasonable and in accordance with the revenue sharing agreement.
- There are adequate controls and processes in place to provide periodic reporting and disclosure of business activities at D/FW.
- The *base year revenues* were reasonable, and the basis for computing *base year revenues* was adequately documented.
- The City of Irving has complied with the terms of the revenue sharing agreement.

Our audit included a review of selected revenues received and reported by the City of Irving from October 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:

- Interviewed management and staff regarding internal accounting controls and various other matters.

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- Conducted site visits to City of Irving property locations at D/FW.
- Reviewed KPMG's *Analysis of Revenues Generated and Expenses Incurred by D/FW International* report dated October 1996.
- Reviewed KPMG's *D/FW Airport Tax Revenue Analysis* report dated September 29, 2000.
- Discussed the inclusion/exclusion of business entities located in the City of Irving at D/FW in the determination of ad valorem taxes with Dallas Central Appraisal District (DCAD) personnel.
- Contacted the Texas Comptroller of Public Accounts Tax Allocation Section and obtained sales and use tax information relevant to the D/FW businesses operating within the City of Irving jurisdiction.
- Reviewed reports and performed analysis.
- Accessed information on the Internet for various property valuations.

Overall Conclusion

The results of our inquiries, examinations, and tests lead us to conclude that:

- Base year revenues were not reasonably determined, and the documentation of the basis is inadequate.
- The City of Irving has not complied with the terms of the revenue sharing agreement.

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

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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.

The Cities of Dallas and Fort Worth jointly own D/FW. D/FW has an eleven-member board comprised of seven members from Dallas and four members from Fort Worth. The 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 table 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 International Airport 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, Irving 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 December 1998, the City of Irving, the City of Dallas, the City of Fort Worth, and the D/FW Board executed an

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interlocal agreement to share revenues. The agreement is perpetual in nature and may only be terminated by the mutual written agreement of all the parties. Base year for the agreement is calendar year 1998, and *base year revenues* for the agreement are \$618,855.

In the agreement, the City of Irving 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:

- Irving – 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 Irving 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 ad valorem tax 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 taxes authorized in Chapters 334 and 335 of the Local Government Code.
- All other general revenue tax levies.

In the revenue sharing agreement, “Property” means that portion of Irving located within the geographical boundaries of 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.

Accounting for the revenues due to the Cities of Dallas and Fort Worth is on a cash basis. The agreement states

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that Irving agrees to pay Dallas and Fort Worth their respective shares of *increased 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 amount of *increased revenues* generated shall be verified by the independent auditor of the City of Irving with the cost of such verification being apportioned based on the percentages specified above.

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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 be all-inclusive of the areas where improvements may be needed.

1. Some information used to determine *base year revenues* is inaccurate and inadequately documented.

The information used to determine the ad valorem tax portion of *base year revenues* is inaccurate. The revenue sharing agreement states *base year revenues* shall be \$618,855, which is the sum of the following amounts:

- “\$600,000, which amount has been determined by the parties hereto as represent the amount of all (i) Ad Valorem Tax Revenues for real and personal property, (ii) Sales Use Tax, (iii) Mixed Beverage Tax, and (iv) other revenues received, credited to, and/or collected by Irving in the Base Year from the Property, excluding municipal court revenues, plus
- “\$18,855, which amount has been determined by the parties hereto as the amount of all municipal court revenues including fines, fees, and court costs resulting from citations written on the Property, excluding fees and costs collected as required by state law, as determined by an independent audit funded by the Board, for the 1997 calendar year for citations written on the Property.”

The list of properties used in computing ad valorem tax revenues is inaccurate. We obtained and reviewed a listing of locations used in the computation of ad valorem taxes. The listing contained taxable values for fifty entities deemed to be located within the City of Irving boundaries at D/FW. The City of Irving showed these entities with a total taxable value of \$130,849,197 for 1998. We compared the City of Irving’s list with the DCAD property tax records to determine whether the list was complete, accurate, and reliable. We noted the following exceptions:

Description	# of Entities	DCAD Taxable Value	Percent of Total Taxable Value
Entities incorrectly shown as located in the City of Irving. DCAD records showed these entities located in the City of Dallas.	10	\$4,618,370	3.53%
Exempt properties included on the listing.	2	\$7,748,210	5.92%
Property value overstated. Listing shows \$7,700,000, DCAD shows \$628,500.	1	\$7,071,500	5.40%
Total Exceptions	13	\$19,438,080	14.85%
Total Taxable Value Used in Determining Base Year Revenues	50	\$130,849,197	
City Auditor’s Adjusted Basis For Determining Base Year Revenues	37	\$111,411,117	

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Based on the information summarized in the table, the total taxable value used to compute ad valorem taxes was overstated by \$19,438,080, or 14.85%. Thus, *base year revenues* are overstated approximately \$96,000. Higher *base year revenues* result in less *increased revenues* to be shared between the Cities of Dallas and Fort Worth.

We recommend that the Chief Financial Officer consult with the City Attorney and determine whether the revenue sharing agreement should be amended to more accurately reflect *base year revenues*.

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

The revenue sharing agreement uses the term “ad valorem tax” revenues in two separate statements (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.

According to the following excerpt from the revenue sharing agreement, it appears that ad valorem tax used in *base year revenues* consider the total ad valorem tax rate.

“Base Year Revenues shall be \$618,855, which is the sum of the following amounts:
1) \$600,000, 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 Irving 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 Irving in any calendar year and which are generated on 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* and the computation of *increased revenues*, the outcome of revenues to be shared will also be different.

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We recommend that the Chief Financial Officer consult with the City Attorney to:

- Ensure that a consistent definition for ad valorem tax is used in all sections of future revenue sharing agreements.
- Determine whether the current revenue sharing agreement should be amended to ensure that the determination of ad valorem tax is consistent between *base year revenues* and *increased revenues*.

3. The City of Irving has not adequately determined whether there are increased revenues to be shared.

The City of Irving did not provide adequate information or documentation to determine whether there are *increased revenues* to be shared. We requested Irving's Director of Finance to provide us with documentation to support whether there are *increased revenues* to be shared for calendar years 1999 and 2000. Irving's Director of Finance provided us with a list of entities used in determining the ad valorem taxes and a computer listing for municipal court revenues.

- A. The information used to determine ad valorem taxes is incomplete, inconsistent, and unreliable. The list (showing market and taxable values for 1999 and 2000) from the City of Irving's Director of Finance included thirty-one entities located within the City of Irving boundaries at D/FW. The information we obtained from the D/FW Real Estate Office included an additional ten entities located in Irving at D/FW.

We also used the DCAD property tax records to check and cross-reference the entities shown on both lists. We found in the DCAD records, for year 2000, nineteen additional entities located at D/FW (Irving) that were not included on the City of Irving's list or the list provided by the D/FW Real Estate Office.

The information in the table below is a summary of the entities we have determined to be located within the City of Irving boundaries at D/FW. This list may not be all-inclusive, but it is based on the information provided to us by the various sources shown.

Sources	# of Entities	Tax Value	Year 2000 Ad Valorem Taxes
City of Irving	31	\$35,626,050	\$173,855
D/FW Real Estate Office	10	\$61,314,000	\$299,212
DCAD	19	\$10,027,840	\$48,936
Totals	60	\$106,967,890	\$522,003

Thus, the information obtained from the City of Irving was incomplete and inaccurate. Without a complete and reliable listing of entities (properties) located

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in the City of Irving boundaries at D/FW, we cannot determine whether there are *increased revenues* to be shared.

- B. The City of Irving did not provide adequate documentation for revenues received from sales and use taxes, mixed beverage taxes, or other revenues, which were generated from entities located in Irving at the D/FW and specified in the agreement.

Additionally, the City of Irving has not provided documentation indicating that Irving's independent auditor had verified *increased revenues*, as required in the revenue sharing agreement. The agreement states the following:

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

Without sufficient documentation to determine *increased revenues* to be shared and without an independent auditor's verification report, there is no assurance that the City of Irving has complied with the financial terms of the agreement. Thus, the City of Dallas cannot reasonably determine whether the City of Irving owes *increased revenues* as defined in the revenue sharing agreement.

We recommend that the Chief Financial Officer consult with the City Manager and request that the City of Irving:

- A. Coordinate information between D/FW Real Estate Office and DCAD and provide a complete and reliable listing of businesses operating within the City of Irving boundaries at D/FW.
- B. Provide adequate documentation to support whether there were *increased revenues* to be shared for calendar years ended 1999 and 2000.
1. Comply with the terms of the agreement and engage their independent auditor to verify whether there are *increased revenues* to be shared.
 2. Remit to the City of Dallas its proportionate share of *increased revenues*.

4. Some sales tax revenue information is not available.

Sales tax revenues on some entities operating within Irving's boundaries at D/FW are not available. Business entities that generate sales taxes are required to file and submit periodic sales tax returns to the Texas Comptroller of Public Accounts.

We contacted the Texas Comptroller's Office and requested information regarding total sales tax revenues reported by business entities operating within the City of Irving's boundaries at D/FW for 1998, 1999, and 2000. The Texas Comptroller's Office provided us with a list showing sixteen business entities with total taxable sales of

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\$78,275.61, \$74,462.48, and \$57,785.55 for 1998, 1999, and 2000, respectively. A note on the list indicated that the total taxable sales amounts were attributed only to eight of the sixteen entities. Additional discussions with a representative of the Texas Comptroller's Office revealed that these eight business entities are considered "outlet" filers. An outlet filer has only one place of business and reports sales taxes collected at the point of sale.

The other eight business entities are called "list filers." Sales tax attributed to the eight list filers were excluded from the total taxable sales amounts listed. List filers operate multiple outlets or make deliveries outside of their metropolitan transit authority. List filers provide one sales tax amount to the state and a separate list of sales tax amounts by city and county. However, the Texas Comptroller's Office representative stated that sales tax revenues specific to the "list filers" businesses operating within the Irving boundaries at D/FW were not available or required by the Texas Comptroller's Office. Therefore, the total for sales tax revenues is not available, and *increased revenues* cannot be accurately determined.

We recommend that the Chief Financial Officer request that the D/FW Real Estate Office:

- Revise its lease agreements and require future lessees to provide periodic sales tax information to D/FW Management.
- Provide total sales tax revenues to Irving's Director of Finance for determination of annual *increased revenues*.
- Consider amending current lease agreements and require current lessees to provide periodic sales tax information to D/FW Management.