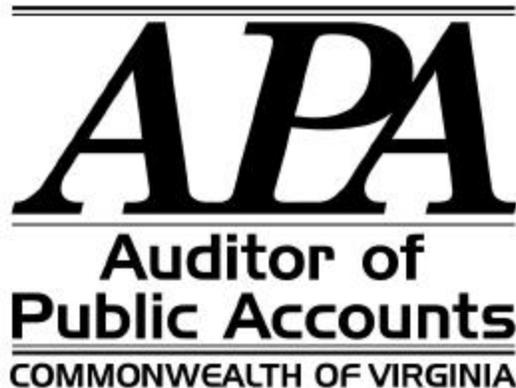


**DEPARTMENT OF AVIATION
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEARS ENDED
JUNE 30, 2000 and 2001**



AUDIT SUMMARY

Our audit of the Department of Aviation for the years ended June 30, 2000 and 2001, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no material weaknesses in internal controls; and
- no instances of noncompliance with applicable laws and regulations that are required to be reported under Government Auditing Standards.

The Department of Aviation and the Aviation Board have made significant commitments to the development of the Newport News-Williamsburg International Airport and the promotion of the Aviation World's Fair 2003, which could result in Aviation committing over \$15 million to the program over the next two years. If Aviation does not receive long-term financing, Aviation would no longer fund the infrastructure for the World's Fair event and would reduce its commitment to develop the infrastructure of the Newport News-Williamsburg International Airport. However, Aviation would still have to delay 10 capital projects at five other airports in the Commonwealth due to Aviation's restriction of the air carrier reliever discretionary funds for the Newport News-Williamsburg International Airport projects.

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The Department of Aviation and the Aviation Board have made commitments to the development of the Newport News-Williamsburg International Airport and the promotion of the Aviation World's Fair 2003, which could result in Aviation committing over \$15 million to the program over the next two years. If Aviation does not receive long-term financing, Aviation would no longer fund the infrastructure for the World's Fair event and would reduce its commitment to develop the infrastructure of the Newport News-Williamsburg International Airport. However, Aviation would still have to delay 10 capital projects at five other airports in the Commonwealth due to Aviation's restriction of the air carrier reliever discretionary funds for the Newport News-Williamsburg International Airport projects.

AVIATION WORLD'S FAIR

The Aviation World's Fair 2003 is the one-hundredth-anniversary celebration of the first powered and controlled flight of a manned machine by the Wright Brothers. Virginia and its partner, the state of North Carolina, are hosting this one-time event at the Newport News-Williamsburg International Airport in April 2003. The Fair will promote business activity among the commercial, general, and military aviation, vertical flight, and space technology industries. The Fair hopes to have global aerospace manufacturers show their latest products, services, hardware, equipment, and aircraft.

Kallman Worldwide incorporated, as "Aviation World's Fair, Inc.," is a private firm specializing in the marketing and management of exhibition space, is organizing the event. Other organizations and agencies directly involved in the Aviation World's Fair 2003 include, but are not limited to: the Secretariats of Transportation, Commerce and Trade, and Natural Resources in Virginia, the North Carolina Aeronautics Council, Virginia jurisdictions and airports, and the staff and agents of federal, state, and local elected officials.

Permanent and Temporary Airport Infrastructure Development

Aviation is performing permanent airport infrastructure development in two phases. Phases I and II are capital improvements to the Newport News-Williamsburg International Airport that Aviation had originally approved on the Airport Layout Plan and scheduled to be completed over the next 10 years. The improvements include enhancements to the apron, taxiway, roadways, and utilities. The airport must now complete these improvements by 2003. Phase III consists of the design and construction of temporary infrastructure to support the actual "event." It includes construction projects specifically necessary for the Fair, such as fencing, parking, roadways, walkways, and subsequent demolition.

The complete airport development project, including Phases I, II, and III, has an estimated total cost of \$31.5 million, funded by a combination of private, state, local, and federal funds. Currently Phases I and II have a total estimated cost of \$26.0 million. The Federal Aviation Administration (FAA) is funding allowable costs in Phase I and II at a participation rate of 45 percent. The Department of Aviation and the Peninsula Airport Commission (PAC) (local share) are funding the remaining expenses.

Aviation World's Fair Event

Phase III has an estimated cost of \$5.5 million. The Virginia Aviation Board, the PAC, and Aviation World's Fair, Inc. will share the Phase III costs at 80 percent, 3 percent, and 17 percent, respectively. These are the only capital funds the Department will spend on the Fair event.

The expected \$31.5 million cost of the permanent and temporary airport development projects is distributed as follows:

PHASE	Estimated Cost:				
	Aviation	Kallman Worldwide, Inc.	PAC	FAA	Total Per Phase
Phase I - Airport Airside	\$ 8,366,651	\$ -	\$2,091,663	\$ 9,953,426	\$20,411,740
Phase II - Airport Landside	3,051,523	-	650,381	1,879,065	5,580,969
Phase III - World's Fair Event	<u>4,456,999</u>	<u>949,050</u>	<u>165,200</u>	<u>-</u>	<u>5,571,249</u>
Totals	<u>\$15,875,173</u>	<u>\$949,050</u>	<u>\$2,907,244</u>	<u>\$11,832,491</u>	<u>\$31,563,958</u>

(Note: Some of these amounts are estimates and subject to change as more information becomes available due to design and bidding.)

Aviation has spent the following amounts through September 30, 2001 for construction, marketing, and promotion for the Aviation World's Fair 2003:

	Fiscal Year 2001	Fiscal Year 2002	Total
Marketing & Promotion	\$ 702,110 ¹	\$ 340,320 ¹	\$1,042,430
Capital Costs	-	<u>2,063,700</u>	<u>2,063,700</u>
Total	<u>\$702,110</u>	<u>\$2,404,020</u>	<u>\$3,106,130</u>

¹ These costs are funded in part by \$250,000 contribution per year from the Virginia Economic Development Partnership and the Virginia Tourism Corporation.

On June 1, 2001, the Peninsula Airport Commission awarded two contracts for the completion of Phase I. The amounts shown for Phase I reflect these contract prices. The bid opening for Phase II was October 15, 2001 and Phase III bidding should occur on May 1, 2002.

In May 2001, the Department of Accounts granted Aviation authorization for a short-term \$7.4 million General Fund operating loan in order to immediately begin the project. Aviation then entered into grant agreements for \$7.4 million with the Peninsula Airport Commission. At the time of the loan authorization, the Commonwealth Airport Fund and the Aviation Special Fund did not have sufficient balances to provide tentative allocation or grants within the normal state grant-in-aid process for the construction of the project. In order to complete the project on schedule (on or before December 1, 2002), Aviation requested the loan as interim financing.

In order to secure the loan, the Comptroller required that Aviation set aside \$7.4 million in funding as security. To comply, the Aviation Board approved the return of certain tentative allocations of the Commonwealth Airport Funds during fiscal year 2001 and deferred allocation of a portion of the fiscal year 2002 air carrier reliever discretionary funds. In addition, the Board also deferred the allocation of special funds for the Airport Maintenance Program, the Facilities and Equipment Program, the Air Service Development and Enhancement Program, and the Aviation Promotion Program.

Although Aviation still has authorization for the loan, they have not drawn down any loan funds to date. The \$7.4 million grant is now supported by fiscal year 2002 appropriations, including cash in the Aviation Special Fund carried forward from fiscal year 2001 and Air Carrier Reliever discretionary funds frozen in fiscal year 2002. The Department plans to return the operating loan to the Department of Accounts.

Phase I of the permanent airport infrastructure development has support from existing grants totaling \$8,894,300. Of this amount, \$7,392,800 represents appropriations (described above). The Aviation Board

allocated the remaining \$1,501,500 and entered into grant agreements for those funds following standard procedures. As of September 6, 2001, Aviation has made one reimbursement for \$149,091.

The Department of Aviation is still seeking long-term debt financing through the General Assembly. If the General Assembly authorizes long-term debt financing, with Treasury Board approval, Aviation will seek financing from the Virginia Resources Authority, using the Airport Revolving Loan Fund Program. If the General Assembly does not approve long-term financing, Aviation will not be able to obtain reimbursement for any money spent to date. As a result, Aviation would no longer fund the infrastructure for the World's Fair event and would reduce its commitment to develop the infrastructure of the Newport News-Williamsburg International Airport. However, Aviation would still have to delay 10 capital projects at five other airports in the Commonwealth due to Aviation's restriction of the air carrier reliever discretionary funds for the Newport News-Williamsburg International Airport projects.

During fiscal year 2001, Aviation transferred funds totaling \$50,000 to the Virginia Tourism Corporation to hire and pay for the salary of a State Steering Committee Coordinator (consultant) to represent the Commonwealth's interests in the construction of the permanent airport infrastructure development and the Aviation World's Fair. In so doing, Aviation bypassed standard procurement procedures required by the Virginia Public Procurement Act. Because the Tourism Corporation is an authority and not a state agency, they are exempt from the Public Procurement Act and state procurement procedures. Aviation cited lack of time for advertising and the need for immediate occupancy of the position as justification for this transaction bypassing the requirements of the Public Procurement Act.

A Letter of Understanding dated April 6, 2001, between Aviation and the Tourism Corporation, documents the transfer of funds to pay the salary of the consultant. The letter provided for Aviation to transfer to the Tourism Corporation the sum of \$150,000 each fiscal year, or appropriate proportional amounts of each fiscal year, beginning March 1, 2001 and ending December 31, 2003, subject to the availability of funding by the General Assembly. The 34-month term consultant's contract called for payment of \$12,500 monthly for a total contract price of \$425,000. On April 19, 2001, Aviation provided \$50,000 to the Tourism Authority for the payment of the consultant's salary for the remainder of the fiscal year (March, April, May, and June 2001). On August 31, 2001, the consultant resigned and the contract terminated. Aviation is responsible for payment of \$25,000 for the months of July and August in fiscal year 2002.

Aviation is in the process of hiring a new consultant using a Request for Proposal. The deadline for submission was October 3, 2001 and a committee is currently reviewing the proposals, although the committee has taken no action as of December 3, 2001.

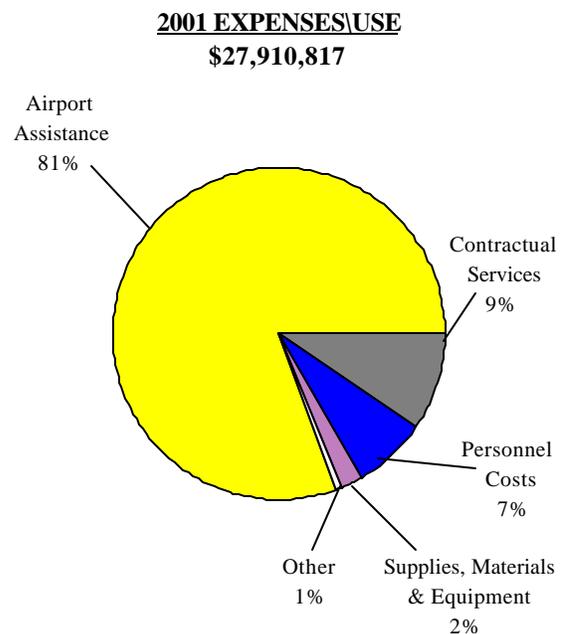
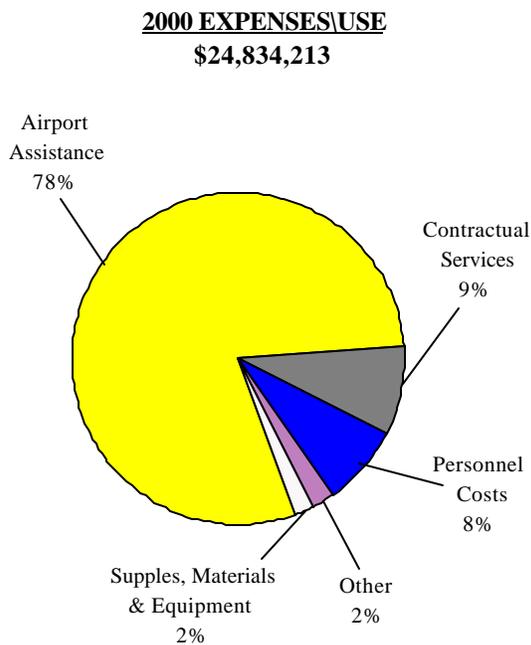
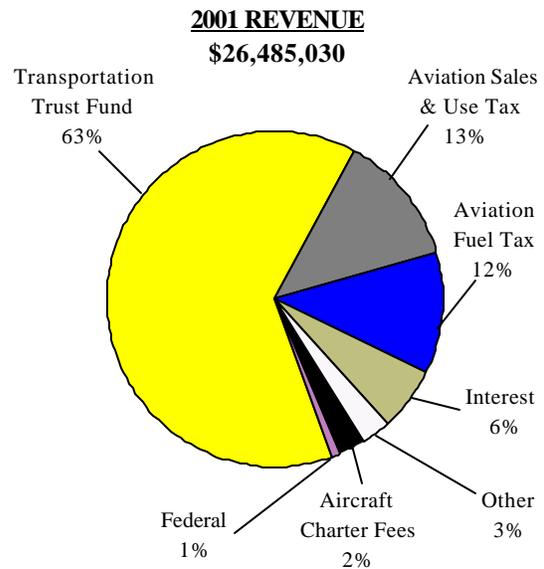
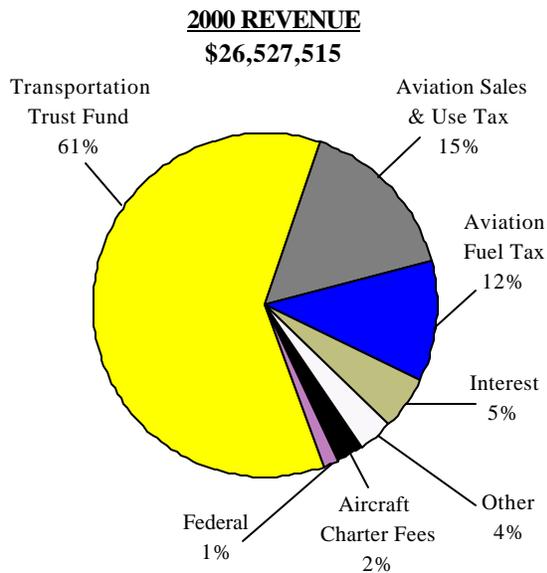
AGENCY BACKGROUND AND FINANCIAL HIGHLIGHTS

The Department of Aviation is a state transportation agency along with the Department of Transportation, Department of Motor Vehicles, Department of Rail and Public Transportation, Motor Vehicle Dealer Board, and Virginia Port Authority.

Aviation consists of the Director's Office and four divisions: Airport Services, Public Relations and Promotion, Flight Operations and Safety, and Finance and Administration. Aviation provides financial and technical assistance to eligible sponsors for the planning, development, promotion, construction, and operation of airports and aviation facilities. It administers applicable provisions of the Code of Virginia, plans for the development of a state aviation system, promotes aviation, and licenses aircraft, airports, and landing areas. Aviation also provides air transportation services to the Governor, the Legislature, and state agencies.

Aviation does not own or operate airports; they provide financial assistance to Virginia airports through grants. Aviation receives the majority of its funding from the Commonwealth Transportation Trust Fund (2.4 percent of the fund's revenues are allocated to the Commonwealth Airport Fund). Aviation's other primary revenue sources are aviation fuel taxes and Virginia aircraft sales and use taxes. The majority of their expenses go for airport assistance.

The following charts depict the revenues and expenses for 2000 and 2001:



Commonwealth Airport Fund

Aviation receives 2.4 percent of the Commonwealth's Transportation Trust Fund revenues and follows statutory requirements for its allocation. By statute, Aviation must commit 40 percent of those funds as entitlement payments to air carrier airports, 40 percent to air carrier reliever airports on a discretionary basis, and 20 percent to general aviation airports on a discretionary basis. Air carrier airports, with the exception of those owned or leased by Metropolitan Washington Airport Authority, receive an allocation of funds based upon the percentage of enplanements for each airport to total enplanements at all carrier airports, with a maximum of \$2 million and a minimum of \$50,000 per year. Air carrier reliever airports and general aviation airports must apply for discretionary funds. Aviation evaluates, prioritizes, and submits recommendations for the discretionary funds to the Virginia Aviation Board for final revision and approval. The Aviation Board allocates the discretionary funds and carries forward any uncommitted funds from the current fiscal year to the next fiscal year for future projects.

Aviation Special Fund

The Special Fund includes collections by the Department of Motor Vehicles for aviation fuel taxes, the Department of Taxation for aircraft sales and use taxes, and Aviation for various department fees. These revenues pay Aviation's administrative expenses and provide funding for airport maintenance, facilities and equipment, promotion, air service development, and airport system planning, regulation, and safety. Effective in fiscal year 1998, Aviation was able to earn interest for its special funds. Aviation earned \$453,730 and \$637,916 in interest in their special fund for fiscal years 2000 and 2001, respectively.

Airports Revolving Loan Fund

The Airports Revolving Loan Fund (ARLF) Program was created by an Act of the 1999 Session of the General Assembly to help provide a low-interest source of funds to assist publicly owned, public-use airport sponsors with capital projects that could not be financed with grants-in-aid from the Commonwealth Airport Fund. Aviation does not maintain the ARLF Program; the Virginia Resources Authority acts as custodian. The Aviation Board has the authority to review and approve loan requests, however, the Virginia Resources Authority maintains the fund and sets the terms and conditions of each loan. Once approved by the Aviation Board, the Virginia Resources Authority will make the awards.

The 2000 Session of the General Assembly provided an initial appropriation of \$25 million in General Funds to establish the Program. As of June 30, 2001, the Virginia Resource Authority has disbursed \$5,769,420 from the fund.

ANNUAL AVIATION CONFERENCE

The Department of Aviation is a participating sponsor of the Annual Aviation Conference. The main purpose of the Annual Aviation Conference is to allow local airports to request funding from the state, to provide participants information concerning requirements in obtaining federal funding, and to provide participants with information concerning aviation, i.e. new laws and problems encountered by airports and the resolutions. The other sponsors of the conference include Virginia Aviation Board, Virginia Airport Operators Council, and Virginia Aviation Business Association and attendees.

Aviation is responsible for handling the administrative duties of the conference, which involves collecting and depositing money for the conference, as well as preparing a financial recap of the conference.

The Department of Aviation pays for all operating expenses incurred by the agency for the conference. These expenses include the rental of booth space for the Aviation display, as well as registration and travel expenses for all of its employees attending the conference.

December 3, 2001

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Aviation** for the years ended June 30, 2000 and 2001. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of Aviation's internal control, and test compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of Aviation's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

- Allocations
- Expenditures
- Revenues

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether Aviation's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

Aviation's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that Aviation properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. Aviation records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted no matters involving internal control and its operation that we consider to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This report is intended for the information of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management on January 15, 2002.

AUDITOR OF PUBLIC ACCOUNTS

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aom:32

DEPARTMENT OF AVIATION
Richmond, Virginia

Kenneth F. Wiegand, Director

AVIATION BOARD MEMBERS

George P. Ramsey, III, Chairman

John G. Dankos, Jr.	Jeanne H. Pedigo
John V. Mazza, Jr.	Joseph H. Ritchie
Robert H. Neitz	William H. Smith

Emmitt F. Yeary