



County of Allegheny

Office of the Controller

DAUPHIN COUNTY GENERAL AUTHORITY
REPORT ON CONTRACT
COMPLIANCE PROCEDURES
FOR THE PERIOD JANUARY 1, 2007
THROUGH DECEMBER 31, 2009

September 20, 2010

**County of Allegheny
Office of the Controller
Mark Patrick Flaherty
Controller**

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MARK PATRICK FLAHERTY
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GUY A. TUMOLO
DEPUTY CONTROLLER

July 12, 2010

Mr. Bradley Penrod
Executive Director
Allegheny County Airport Authority
Landside Terminal, 4th Floor Mezzanine
P.O. Box 12370
Pittsburgh, PA 15231-0370

**SUBJECT: Compliance Procedures Applied to Amended and Restated
Lease Agreement #39205-A Between Dauphin County General
Authority and Allegheny County Airport Authority for
the Period January 1, 2007 through December 31, 2009**

Dear Mr. Penrod:

We have applied contract compliance procedures to the Amended and Restated Lease Agreement #39205-A (the "Agreement") between Allegheny County (the Allegheny County Airport Authority is now responsible for compliance and enforcement) and Dauphin County General Authority ("Dauphin Authority"). We performed these compliance procedures to ensure that Dauphin Authority was in compliance with the scope and terms of the Agreement. Our compliance procedures covered the period from January 1, 2007 through December 31, 2009. Our engagement was performed as a non-audit service, and therefore was not conducted in accordance with *Government Auditing Standards*.

The application of our compliance procedures revealed Dauphin Authority is not in compliance with the Agreement with respect to the determination of and payment of rent. Dauphin Authority also is not in compliance with the provision of the Agreement that requires submission of an annual report certified by an officer to the Allegheny County Airport Authority ("Airport Authority") within 90 days of the end of each lease year.

Mr. Bradley Penrod
July 12, 2010

Dauphin Authority should take steps to ensure that lease payments to the Airport Authority for room revenue are calculated in accordance with the manner prescribed in the Agreement for the purpose of remitting lease payments to the Airport Authority. Dauphin Authority should also take steps to ensure that the required annual report is submitted in a timely fashion.

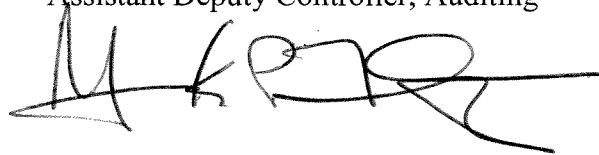
We believe that the implementation of our recommendations will improve Dauphin Authority's compliance with the Agreement. The results of the application of our compliance procedures are provided in the attached report.

We would like to thank the management and staff of the Hyatt Hotel and Dauphin Authority for their courtesy and cooperation during the performance of our procedures.

Very truly yours,



Lori A. Churilla
Assistant Deputy Controller, Auditing



Mark Patrick Flaherty
Controller

cc: Honorable Richard Fitzgerald, President, County Council
Honorable William Russell Robinson, County Council
Honorable Dan Onorato, Chief Executive
Mr. James M. Flynn, Jr., County Manager
Ms. Amy Griser, Budget Director
Allegheny County Airport Authority Board
Mr. Joseph Catanese, Director of Constituent Services
Ms. Jennifer Liptak, Budget Director, County Council
Ms. Cynthia Boratko, Executive Director, Dauphin County General Authority
Mr. Guy A. Tumolo, Deputy Controller
Mr. Robert J. Lentz, Assistant Deputy Controller, Accounting
Ms. Pamela Goldsmith, Communications Director

EXECUTIVE SUMMARY

Purpose of Procedures: We performed our compliance procedures to ensure that Dauphin County General Authority (“Dauphin Authority”) is in compliance with the scope and terms of the Amended and Restated Lease Agreement #39205-A.

Background: Allegheny County entered into the Amended and Restated Lease Agreement #39205-A (the “Agreement”) with Dauphin Authority to facilitate the construction and operation of a first class hotel at the Pittsburgh International Airport. Under the agreement, Dauphin Authority was to construct, own, and operate the Hyatt Hotel and Conference Center (“Hotel”). The County entered into the Agreement for a period of forty-nine (49) years beginning April 23, 1998. The Allegheny County Airport Authority is now responsible for compliance with and enforcement of the Agreement.

Under the Agreement, Dauphin Authority is required to pay the Airport Authority rent in the amount of 4% of room revenue generated by the Hotel per annum. Room revenue is defined in the Agreement as the total revenue received from the rental of guest rooms, forfeitures of deposits, and guarantees of guest rooms by Dauphin Authority or its manager, less receivables outstanding for more than 120 days and any taxes paid. Dauphin Authority is also required to pay to the Airport Authority 90% of all surplus revenue received from operation of the Hotel for each calendar year as surplus rent. Surplus revenue is defined in the Agreement as total revenue received from operation of the Hotel less operating expenses, which are defined as management fees as set forth in the management agreement, brand costs, FF&E (furnishings, fixtures and equipment), and reserves as set forth in the management agreement and financing documents, so long as the expenses are needed to maintain the Hotel in a manner consistent with industry standards for a first class hotel.

Results in Brief: While performing our procedures, we noted that Dauphin Authority should take steps to ensure that rent payments to the Airport Authority are calculated using room revenue as defined in the Agreement. Dauphin Authority should also take steps to ensure that the required annual report is submitted in a timely fashion.

EXECUTIVE SUMMARY

Specifically, we found that:

Finding #1

- Dauphin Authority did not include room cancellation and attrition penalties in the room revenue used to calculate the rent payments remitted to the Airport Authority for the years ended December 31, 2007, 2008 and 2009. This resulted in an aggregate underpayment of rent for those years in the amount of \$10,142.

Finding #2

- Dauphin Authority did not submit to the Airport Authority an annual report certified by an officer as being accurate and complete based on his or her examination of the books, records and accounts within 90 days of the calendar year-end as required by the Agreement for 2007, 2008, or 2009.

Recommendations:

We recommend that Dauphin Authority management:

Recommendation #1

- Immediately pay the Airport Authority \$10,142, the aggregate amount of unpaid rent for 2007, 2008, and 2009 attributable to room cancellation and attrition penalties.
- Implement procedures to ensure that future lease payments to the Airport Authority are calculated using room revenue as defined in the Agreement.

Recommendation #2

- Establish procedures to ensure that an annual report that has been certified by an officer of Dauphin Authority is submitted to the Airport Authority within 90 days of each calendar year-end as required by the Agreement.

I. Introduction

Background:

Allegheny County entered into the Amended and Restated Lease Agreement #39205-A (the "Agreement") with Dauphin Authority to facilitate the construction and operation of a first class hotel at the Pittsburgh International Airport. Under the agreement, Dauphin Authority was to construct, own, and operate the Hyatt Hotel and Conference Center ("Hotel"). The County entered into the Agreement for a period of forty-nine (49) years beginning April 23, 1998. The Allegheny County Airport Authority is now responsible for compliance with and enforcement of the Agreement.

Under the Agreement, Dauphin Authority is required to pay the Airport Authority rent in the amount of 4% of room revenue generated by the Hotel per annum. Room revenue is defined in the Agreement as the total revenue received from the rental of guest rooms, forfeitures of deposits, and guarantees of guest rooms by Dauphin Authority or its manager less receivables outstanding for more than 120 days and any taxes paid. Dauphin Authority is also required to pay to the Airport Authority 90% of all surplus revenue received from operation of the Hotel for each calendar year as surplus rent. Surplus revenue is defined in the Agreement as total revenue received from operation of the Hotel less operating expenses, which are management fees as set forth in the management agreement, brand costs, FF&E (furnishings, fixtures and equipment), and reserves as set forth in the management agreement and financing documents, so long as the expenses are needed to maintain the Hotel in a manner consistent with industry standards for a first class hotel.

The Agreement indicates that estimated rent shall be paid quarterly in arrears on a calendar year basis in the amount of one quarter of the prior year's actual rent (4% of room revenue as defined in the Agreement). The payment to be made by Dauphin Authority at the end of the first calendar quarter of each year is to be adjusted to include the difference between the prior year's actual rent and the estimated rent paid for the prior year. If the prior year's estimated rent paid exceeds the actual rent due for the prior year, the Airport Authority is to credit the overpayment against the next quarterly estimated rent payment due the County.

The Agreement also requires Dauphin Authority to provide an audited financial statement ("annual report") to the Airport Authority within 90 days of each calendar year-end showing room revenue and surplus revenue generated by the Hotel. The annual report is to be prepared in accordance with accounting principles generally accepted in the United States of America and certified by

I. Introduction

an officer of Dauphin Authority as being accurate and complete based on such officer's examination of the books, records and accounts.

II. Scope and Methodology

We applied compliance procedures to Amended and Restated Lease Agreement #39205-A between the Airport Authority and Dauphin Authority to ensure that Dauphin Authority was in compliance with the scope and terms of the Agreement. Our compliance procedures covered the period from January 1, 2007 through December 31, 2009.

Specifically, we performed the following procedures:

- Interviewed Hyatt Hotel and Conference Center personnel to gain an understanding of the processes and internal controls over the recording of room revenue and receivables.
- Examined records of the Hotel and the Airport Authority that were relevant to the administration of the Agreement to determine compliance with the Agreement.
- Applied procedures to determine that Dauphin Authority submitted the required annual reports to the Airport Authority.
- Applied procedures to determine the completeness of room revenue reported to the Airport Authority and used to calculate Dauphin Authority's rent payments under the Agreement.
- Applied procedures to determine whether rent payments were made timely and in the proper amount.
- Applied procedures to determine whether surplus (deficit) revenue was calculated in the manner prescribed by the Agreement.

We performed these procedures during July 2010. We provided a draft copy of this report to the Executive Director of Dauphin County General Authority for response (see page 12).

III. Findings and Recommendations

Finding #1

Underpayment of Rent

Section 6 of the Agreement stipulates that rent for the leased premises (Hotel) will be 4% of room revenue. Room revenue is defined in the Agreement as the total revenue received from the rental of guest rooms, forfeitures of deposits, and guarantees of guest rooms by Dauphin Authority or its manager, less receivables outstanding for more than 120 days and any taxes paid.

The footnotes in the 2008 and 2009 annual reports submitted by Dauphin Authority acknowledged that the Agreement defines room revenues to be used for the purpose of calculating annual rent payable to the Airport Authority (Dauphin Authority did not file an annual report for 2007 – see Finding 2). However, the amount reported in the annual reports under the room revenue caption for both years and the room revenue used to calculate the 2007 rent payment did not include revenues related to cancellation and attrition penalties. Cancellation penalties represent penalty income received from groups that cancel their reservations for guest rooms after a contracted date. Attrition penalties represent penalty income received from groups that do not fulfill their guaranteed number of reservations for guest rooms. The cancellation and attrition penalties were clearly includible in room revenue based on the definition contained in the Agreement. Room revenues used for purposes of calculating Dauphin Authority's rent payments to the Airport Authority were understated by \$96,755, \$105,895, and \$50,911 for 2007, 2008, and 2009, respectively (\$253,561 in the aggregate). Consequently, actual rent paid to the Airport Authority was deficient by \$3,870, \$4,236, and \$2,036 for 2007, 2008, and 2009, respectively (\$10,142 in the aggregate).

We noted that there are a number of accounts within the Hyatt's chart of accounts used to record room revenue. It appears that this condition occurred because the two accounts utilized to record revenues related to room cancellations and attrition penalties were not identified for inclusion in the room revenue to be used for the calculation of rent. The effect of this condition is that Dauphin Authority is out of compliance with Section 6 of the Agreement, and that Dauphin Authority has an aggregate liability to the Airport Authority of \$10,142 related to the underpayment of rent for 2007, 2008, and 2009.

III. Findings and Recommendations

Recommendations

We recommend that Dauphin Authority:

- Immediately pay the Airport Authority \$10,142, the aggregate amount of unpaid rent for 2007, 2008, and 2009 attributable to room cancellation and attrition penalties.
- Implement procedures to ensure that future rent payments to the Airport Authority are calculated using room revenue as defined in the Agreement.

III. Findings and Recommendations

Finding #2

Untimely Submission of Annual Reports

Section 40 of the Agreement requires Dauphin Authority to provide an audited financial statement (“annual report”) to the Airport Authority within 90 days of each calendar year-end showing room revenue and surplus revenue generated by the Hotel. The annual report is to be prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and certified by an officer of Dauphin Authority as being accurate and complete based on such officer’s examination of the books, records and accounts.

We observed that annual audits of the Hotel are routinely performed (KPMG performed those audits for at least the past three years). However, these audits do not satisfy the requirements contained in the Agreement since they do not report room revenues or surplus revenues as defined in the Agreement. To comply with the Agreement, Dauphin Authority engaged other auditors in 2008 and 2009 (Maher Duessel) to audit its schedule of ground rent and surplus revenues. For 2008 and 2009, these audits were submitted as the annual reports required by the Agreement.

We observed that the annual report for 2009 was dated May 12, 2010, and that the annual report for 2008 was dated August 6, 2009. Based on this, the annual reports for those years could not have been submitted to the Airport Authority in a timely fashion. We also observed that the annual reports were not certified by an officer of Dauphin Authority as required. In addition, an annual report meeting the requirements of section 40 of the Agreement was not filed by Dauphin Authority for 2007 (although rent was paid for 2007 based on room revenue reported in the Hotel’s 2007 financial statements which were audited by KPMG).

It appears that these conditions may have been caused by a lack of awareness regarding the established reporting requirements. The effect of these conditions is that Dauphin Authority is out of compliance with section 40 of the Agreement.

Recommendation

We recommend that Dauphin Authority:

- Take steps to ensure that an annual report that meets the established reporting requirements is submitted to the

III. Findings and Recommendations

Airport Authority within 90 days of each calendar year-end as required by the Agreement.

DAUPHIN COUNTY GENERAL AUTHORITY

Barbara A. Zemlock, Chairperson
David M. Transue, Vice-Chairman
Abby L. Gabner, Secretary
Robert J. DeSousa, Treasurer
Douglas S. Gelder, Asst. Secretary/Asst. Treasurer

*530 South Harrisburg Street, Harrisburg, PA 17113
Telephone: 717-985-1627
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Cynthia L. Boratko, Executive Director

September 13, 2010

Mark Patrick Flaherty
Office of the Controller
104 Courthouse- 436 Grant Street
Pittsburgh, PA 15219-2498

Dear Mr. Flaherty:

Contract compliance procedures were conducted on July 13, 2010, during which the Allegheny County Controller's Office reviewed and analyzed numerous documents pertaining to the room revenue calculations at the Hyatt Regency Hotel at the Pittsburgh Int'l Airport.

A follow up exit conference took place on September 8, 2010 at 10:00AM and was conducted by the Allegheny Controller's Office-Audit Division. The following were participants in the exit conference call: David Transue, Vice Chair/Chair of the Audit Committee of Dauphin County General Authority (Authority); Cynthia Boratko, Executive Director of the Authority; Tracey Rash, CPA, CGFM, Partner, Maher Duessel; Carol Conti, Senior Controller Hyatt Regency Pittsburgh Int'l Airport; Eric Ruprecht, Director of Business Administration & Properties Airport Authority; Stephen Robinson, Controller Airport Authority; Jeff Vargas, CPA, Audit Manager, Allegheny County Controller's Office - Audit Division; and Lori Churilla, Assistant Deputy Controller – Auditing.

The contract compliance procedures resulted in two (2) findings which will require remediation from the Authority via a written response.

The first finding presented within the contract compliance procedures states that room cancellation and attrition penalties in the room revenue were not used in the calculation of the rental payments for the years ended December 31 2007, 2008, and 2009. As a result, an aggregate underpayment of rent for those years, in the amount of \$10,142, is due to the Airport Authority.

In response to the contract compliance procedures and the understandings from the exit conference call, the Authority hereby acknowledges the above underpayment and agrees that payment is due based upon Section 6 (iii) of the lease agreement pertaining to payments by the Authority. Therefore, said payment will be processed and submitted to the Airport Authority pending Board of Director approval at our September 15, 2010 Board Meeting.

The second finding pertains to the submission of the annual audit report to the Airport Authority within 90 days of each calendar year end as required by the Agreement. In addition, the land rental agreement requires that an officer of the Authority certify the annual report is accurate and complete based upon an examination of the books, records, and accounts. During the conference call, it was agreed that the certification acceptable by the Airport Authority is in a form of a cover-letter signed

by the Chair of the Audit Committee and the Executive Director of the Authority accompanying the annual audited financial statements of the Hyatt Regency Pittsburgh Int'l Airport.

Furthermore, as affirmative action the Authority has requested that our management company- Hyatt Regency Pittsburgh Int'l Airport make certain that the audit firms selected to conduct the annual hotel audit, hereafter, ensure that a footnote with the calculated rent inclusive of room rentals, forfeitures of deposit and guarantees (attrition and cancellation of rooms which shall be incorporated in other rentals) for rooms less uncollectible accounts of guest rooms in excess of 120 days old and any taxes paid in connection therewith, be included in the annual audited financial statement of the Hyatt Regency Pittsburgh Int'l Airport. Additionally, the Authority's management company, Hyatt Regency Pittsburgh Int'l Airport, must be in receipt of the final audit report no later than by the 15th of March, so compliancy of the submission to the Airport Authority falls within the 90 days required by the land rental agreement.

For historical purposes, the following notation is being made. It was agreed-upon by the Airport Authority that the submission of the Surplus Revenue Report and the Annual Audit of the Authority by the end of June of each calendar year is an acceptable timeframe of submission.

We thank you for bringing these findings to our attention. It is our intention to address the items immediately in order that the Authority is in compliance with these items per our agreement with the Airport Authority. However, should there be a difference of opinion with our response to the contract compliance procedures and the understandings from the exit conference call of September 08, 2010, please advise the undersigned by September 30, 2010.

Sincerely,



David M. Transue
Vice Chairman/Chair of Audit Committee



Cynthia L. Boratko
Executive Director

Cc:

Barbara A. Zemlock, *Chair- Dauphin County General Authority*
 Guy Beneventano, *Solicitor- Dauphin County General Authority*
 Eric Ruprecht, *Director of Business Administration & Properties Airport Authority*
 Stephen Robinson, *Controller Airport Authority*
 Jeff Vargas, *CPA, Audit Manager, Allegheny County Controller's Office - Audit Division*
 Lori Churilla, *Assistant Deputy Controller – Auditing*
 Tracey Rash, *CPA, CGFM, Partner Maher Duessel*
 Carol Conti, *Senior Controller Hyatt Regency Pittsburgh Int'l Airport*