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**CITY OF SAN ANTONIO**  
**OFFICE OF THE CITY AUDITOR**



Audit of the Billing and Collections Process for Leases in the

Aviation Department

Project No. AU08-010

August 19, 2009

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# Executive Summary

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As part of the annual Audit Plan, we conducted an audit of the Billing and Collections Process for Leases in the Aviation Department (Aviation). The audit objectives, conclusions, and recommendations follow:

## 1) Are rents received consistent with lease terms?

Rents received are consistent with lease terms. However, we identified a number of operational and accounting processes requiring improvement. Specifically, Aviation:

- Has not entered into a written lease agreement with a tenant occupying office space in Terminal 1 since October 2007,
- Incorrectly calculated the Signatory Airline refund by \$57,000 for fiscal year 2008,
- Recognized net, rather than gross, lease revenue in certain circumstances,
- Has not written-off uncollectible receivable balances since 1992.

We recommend the Aviation Director:

- Execute a written lease agreement with all tenants.
- Pay Signatory Airlines the \$57,000 due for the fiscal year 2008 airline refund.
- Record lease revenue at gross amounts. Record credits provided to tenants for property improvements and economic development in the appropriate expenditure accounts.
- Write-off uncollectible receivable balances.

## 2) Is the collection process effective for delinquent accounts?

The collection process for delinquent accounts is not effective. Of the \$3.9 million in accounts receivable balances, \$1.3 million is greater than 1 year old. Aviation did not send required sixty-day dunning letters on delinquent balances. In addition, there was no evidence that Aviation contacted the City Attorney's Office for assistance in collection of delinquent accounts. These collection procedures are required in Aviation's Lease Policy. Moreover, the Department does not charge late fees on delinquent balances as required in lease agreements.

We recommend the Aviation Director:

- Develop detailed procedures for collection of delinquent accounts. The procedures should address staff responsibilities, the frequency and type of active collection attempts, and monitoring the aging of accounts receivable.
- Charge tenants late fees in accordance with the terms of the respective lease agreements. In addition, include specific late fee rates in new lease agreements.

Management's verbatim response is at **Appendix C** on page 8.

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## Background

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There are 75 lease agreements between Aviation and commercial airlines, corporations and related businesses at the International Airport; excluding retail and food concessionaires. Lease terms for these agreements range from 1 to 40 years. For fiscal year 2008, the Aviation Department recognized approximately \$68.0 million in operating revenue. Of this amount, rental revenue was approximately \$25.7 million from Airport terminal, building, and property leases.

The Aviation Department established 13 commercial airlines as Signatory Airlines<sup>1</sup>. These airlines receive monthly refunds applied to their rental fees based on the airport's realized profits. During fiscal year 2008, Signatory Airlines received refunds of approximately \$7.4 million.

The Aviation Department has used the DataPoint system to manage lease billing and collections for over 24 years.

## Audit Scope and Methodology

The audit scope included 75 lease agreements at International Airport as of September 30, 2008. We selected a random attribute sample of 31 lease agreements totaling \$7.7 million for detail testing. We also reviewed the processing of all daily collections received for September 2008.

We interviewed personnel from Aviation's Fiscal and Properties Management areas. We also created flowcharts to gain an understanding of relevant processes. Several DataPoint system reports used by Aviation personnel, including the Aged Trial Balance, Accounts Receivable Transaction Register and Accounts Receivable History Listing, were reviewed during the course of our audit.

We relied on computer-processed data in the DataPoint system to validate lease terms and billing data. We performed direct tests of the data rather than evaluating the system's general and application controls. Our tests included tracing DataPoint data to executed lease agreements. We do not believe that the absence of testing general and application controls had an effect on the results of our audit.

We conducted this audit from November 2008 to January 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate information to provide a reasonable basis for the results based on the audit objectives. We believe that the information obtained provides a reasonable basis

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<sup>1</sup> A Signatory Airline is a scheduled air carrier that has an agreement with the City for exclusive use of airport space and gate(s).

for the results based on the audit objectives. Our audit included tests of management controls that we considered necessary under the circumstances.

## Audit Results and Recommendations

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### A. Operational and Accounting Processes

#### A.1 Lease Agreement.

Since October 2007, a tenant has occupied 815 square feet of office space based on a verbal lease agreement with the Aviation Department. Rental payments were comparable to market rates for other leased properties. However, City Council requires the authorization of all rental agreements through City Ordinance. A formal lease protects the interests of the City.

#### A.2 Errors in Calculating the Signatory Airline Refund.

The 2008 Signatory Airline refund was understated. The calculation included an *estimated* subsidy amount of the Federal Inspection Station (FIS) instead of the *final* subsidy amount (\$46,000 impact). According to terms in lease agreements, the final FIS subsidy should be included as part of the refund provided to Signatory Airlines. Moreover, while the refund calculation should not include the amount received from the sale of assets, management inadvertently excluded the amount received twice (\$11,000 impact). As a result, Aviation underpaid Signatory Airlines by approximately \$57,000 for fiscal year 2008.

#### A.3 Net Revenue Recognized in Certain Situations.

Aviation Department recognized net, rather than gross, lease revenue. The Department reduced the amount of lease revenue by the value of tenant provided property improvements and economic development credits prior to recording in the accounting records. Property improvements and economic development credits are not offsets against revenue according to generally accepted accounting principles (GAAP). Depending on the nature and dollar amount, these transactions should be capitalized or expensed. Based on Aviation's accounting practices, the department netted approximately \$1.6 million and \$1.1 million in credits against revenue in the City's financial statements for fiscal years 2008 and 2007, respectively. Consequently, revenue was understated in the financial statements.

#### A.4 Write-offs of Uncollectible Balances.

The Aviation Department has not written-off any accounts receivable classified as uncollectible since 1992. Currently, the department considers approximately \$489,000 in accounts receivable as uncollectible. While net accounts receivable may be fairly stated after consideration of the allowance for doubtful accounts, accounts determined to be uncollectible should be written-off. Otherwise, the gross accounts receivable balance in the accounting records will be overstated.

**Recommendations:** Aviation Director should:

A.1 Execute a written lease agreement with all tenants.

A.2 Pay Signatory Airlines the \$57,000 due for the fiscal year 2008 airline refund.

A.3 Record lease revenue at gross amounts. Record credits provided to tenants for property improvements and economic development in the appropriate expenditure accounts.

A.4 Write-off uncollectible receivable balances.

**B. Collection of Delinquent Balances and Late Fees**

**B.1 Collection Efforts on Delinquent Accounts.**

The collection process for delinquent accounts is not effective. Aviation’s Properties Management did not perform sufficient collection efforts on past due receivables. Aviation has not sent required sixty-day dunning letters to delinquent tenants. In addition, there was no evidence that Aviation’s Properties Management contacted the City Attorney’s Office for assistance in collection of delinquent accounts as required in Aviation’s Lease Policy. As of September 30, 2008, there was approximately \$3.9 million in accounts receivable, of which \$1.3 million (33%) related to balances older than one year. As accounts receivable balances age, the lack of timely collection efforts decreases the probability of collecting delinquent balances. See **Exhibit 1** for details.

**Exhibit 1 – Aged Accounts Receivable as of September 30, 2008**

<b>Past Due Category</b>	<b>Balance</b>
Current - 10 days	\$ 773,655
11-60 days	669,372
61-90 days	192,365
91-180 days	607,633
181-365 days	360,518
Over 1 year	1,271,095
<b>Total Accounts Receivable</b>	<b><u>\$ 3,874,638</u></b>

Source: Aviation Department

**B.2 Late fees on Delinquent Balances.**

The Aviation Department has not charged late fees to delinquent tenants. Lease agreements require tenants to pay late fees when account balances are more than 10 days past due. Some lease agreements include a 10% interest rate for late fees while others state that an amount “equal to the maximum allowable under state statutes may be assessed.”<sup>2</sup> Charging late fees provides an incentive for tenants to remit rents on time.

<sup>2</sup> Texas Finance Code, Title 4, Subtitle A, Chapter 302, Subchapter A, Section 302.002 allows six percent as the maximum rate for late fees when a rate is not specified in an agreement.

**Recommendations:** Aviation Director should:

B.1 Develop detailed procedures for collection of delinquent accounts. The procedures should address staff responsibilities, the frequency and type of active collection attempts, and monitoring the aging of accounts receivable.

B.2 Charge tenants late fees in accordance with the terms of the respective lease agreements. In addition, include specific late fee rates in new lease agreements.

## Appendix A – Glossary of Terms

**Airline Refund** – An annual amount refunded to Signatory Airlines based on the prior year's financial results of the airport. The Airline Refund recognizes the interdependent relationship of the financial success of the Airport and the airlines. The lease agreement contains the basis for calculating refunds.

**Gross Revenue** – The total amount billed for services before any discounts or credits are applied.

**Net Revenue** – The revenue amount reduced by credits or other related costs.

**Signatory Airline** – A scheduled air carrier that has an agreement with the City for exclusive use of airport space and gate(s).

## **Appendix B – Staff Acknowledgement**

Barry Lipton, CPA, DABFA, Deputy City Auditor  
Denis Cano, CPA, CIA, CISA, Audit Manager  
Kevin Barthold, CPA, CIA, CISA, Auditor-in-Charge  
Tanya Rodriguez, Auditor

## Appendix C – Management Response



# CITY OF SAN ANTONIO

SAN ANTONIO TEXAS 78283-3966

Park E. Pearson, CPA  
 City Auditor  
 San Antonio, Texas

RE: Management's Corrective Action Plan for the Audit of the Billing and Collections Process for Leases in the Aviation Department

The Aviation Department has reviewed the audit report and has developed the Corrective Action Plans below corresponding to report recommendations.

Recommendation					
#	Description	Audit Report Page	Accept, Partially Accept, Decline	Responsible Person's Name/Title	Completion Date
<b>A.1</b>	<b>Lease Agreement</b> Aviation Director should execute a written lease agreement with all tenants.	3	Accept	Eric Kaalund, Steve Milburn; Aviation Department	8/6/2009
<b>Action plan:</b> Aviation reviewed, and modified as necessary, procedures to ensure that all tenants have a written lease agreement. The tenant lease noted as an exception is currently in review and will go to Council for approval on August 6, 2009.					
<b>A.2</b>	<b>Errors in Calculating the Signatory Airline Refund</b> Aviation Director should pay Signatory Airlines the \$57,000 due for the fiscal year 2008 airline refund.	3	Accept	Eric Kaalund, Freddy Martinez; Aviation Department	Completed
<b>Action plan:</b> Aviation is working with the Finance department to review and modify as necessary, procedures to ensure that the annual Airline Refund Calculation is complete and accurate. The \$57,000 will be applied to the Airlines' outstanding accounts receivable balances on a pro rata basis.					
<b>A.3</b>	<b>Net Revenue Recognized in Certain Situations</b> Aviation Director should record lease revenue at gross amounts. Record credits provided to tenants for property improvements and economic development in the appropriate expenditure accounts.	4	Accept	Eric Kaalund, Freddy Martinez; Aviation Department	Completed


Aviation Billing and Collections Process for Leases

Recommendation					
#	Description	Audit Report Page	Accept, Partially Accept, Decline	Responsible Person's Name/Title	Completion Date
<p><b>Action plan:</b> Aviation is in the process of converting all leases and billing transactions into SAP. Lease revenues will be recorded into SAP as gross amounts. As part of the conversion, Aviation has established specific general ledger accounts to track the different types of credits granted to tenants. Aviation will work with Finance to ensure that these credits are expensed, recorded as a discount or recorded as construction in progress depending on the circumstances related to the credit.</p>					
A.4	<p><b>Write-offs of Uncollectible Balances</b></p> <p>Aviation Director should write-off uncollectible receivable balances.</p>	4	Accept	Eric Kaalund, Freddy Martinez, Steve Milburn; Aviation Department	Completed
<p><b>Action plan:</b> Aviation analyzed and reported to Finance those accounts deemed 100% uncollectible. Aviation initiated follow up procedures to ensure proper actions are taken to write off uncollectible accounts receivables reported to Finance.</p>					
B.1	<p><b>Collection Efforts on Delinquent Accounts</b></p> <p>Aviation Director should develop detailed procedures for collection of delinquent accounts. The procedures should address staff responsibilities, the frequency and type of active collection attempts, and monitoring the aging of accounts receivable. Efforts to date have resulted in reducing the accounts receivable by \$1.4 million.</p>	5	Accept	Eric Kaalund, Steve Milburn; Aviation Department	Completed
<p><b>Action plan:</b> Aviation developed detailed procedures for delinquent accounts that address staff responsibilities, the frequency and type of active collection attempts, and monitoring of aging accounts on a timely basis. This will be enhanced by Aviation's conversion from Data Point to SAP as well as the new Accounts Receivable A.D.</p>					
B.2	<p><b>Late fees on Delinquent Balances</b></p> <p>Aviation Director should charge tenants late fees in accordance with the terms of the respective lease agreements. In addition, include specific late fee rates in new lease agreements.</p>	5	Accept	Eric Kaalund, Steve Milburn, Freddy Martinez; Aviation Department	Completed
<p><b>Action plan:</b> Aviation developed procedures to ensure that tenants are charged late fees in accordance with the terms of the lease agreements. In addition, all new leases will contain specific rates with regards to potential late fee charges.</p>					

We are committed to addressing the recommendations in the audit report and the plan of actions presented above.

Sincerely,

  
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Frank R. Miller  
Director  
Aviation Department

  
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Penny Post oak-Ferguson  
Assistant City Manager  
City Manager's Office