



# CITY OF SAN ANTONIO

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May 13, 2010

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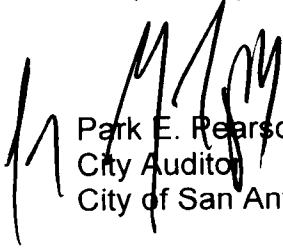
Mayor and Council Members:

SUBJECT: Downtown Operations Department - River Walk Leases Audit Report

We are pleased to send you the audit report of the Downtown Operations Department, River Walk Leases. This audit began in September 2009 and concluded with an exit meeting with department management in April 2010. Management's verbatim response is included in Appendix C of the report. The Downtown Operations Department should be commended for its cooperation and assistance during this audit.

The Office of the City Auditor is available to discuss this report with you individually at your convenience.

Respectfully submitted,

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

**Distribution:**

**Sheryl L. Sculley, City Manager**  
**Pat DiGiovanni, Deputy City Manager**  
**Paula X. Stallcup, Director, Downtown Operations Department**  
**Michael D. Bernard, City Attorney**  
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**Catherine J. Hernandez, Interim Executive Assistant to the City Manager**  
**Stanley Blend, Audit Committee Member**  
**Manuel Long, Audit Committee Member**

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



Audit of Downtown Operations Department

River Walk Leases

Project No. AU09-013

May 13, 2010

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## Executive Summary

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As part of our annual Audit Plan approved by City Council, we conducted an audit of the Downtown Operations Department, specifically the River Walk leases. The audit objective, conclusion, and recommendations follow:

### **Are River Walk leases appropriately complied with and documented?**

Generally, lessees complied with lease terms and City management appropriately documented leases. However, insurance requirements were not satisfied and renewals of leases were not timely.

We recommend that the Downtown Operations Department:

- Work with Risk Management (a Division of Human Resources) to ensure that leases contain appropriate insurance coverage types and amounts needed to protect the City's interests.
- Ensure that each business complies with the insurance requirements of the lease.
- Begin the renewal process with sufficient lead-time to ensure timely execution of leases.
- Agree upon and document interim rent when a new lease is not negotiated prior to expiration of the existing lease.

Management's verbatim response is included at Appendix C on page 7.

## Other Matters

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One River Walk business is operating in City space without a lease. Because this business disputes the City's ownership of the property in question, Downtown Operations has been working with a surveyor and outside council to obtain a lease and boundary line agreement. According to a 2009 survey, the business has a balcony that extends approximately 376 square feet into the City's air space.

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## Background

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The City of San Antonio (COSA) has leased sections of the River Walk to adjacent business owners since 1957. In the 1990's, several business owners along the River Walk disputed the City's ownership of this property. The City hired legal council to defend its ownership position and a trial date was set for 2001. However, the case never went to trial; instead, a settlement was reached in August 2001 that was approved by City Council through Ordinance 94561. As part of the settlement, the defendants agreed that COSA owns the River Walk. In 2006, the City created the Downtown Operations Department (hereafter referred to as Downtown Operations). Among other duties, Downtown Operations is responsible for managing the City's River Walk leases, a function performed by the Parks and Recreation Department until October 1, 2006. Downtown Operations manages 37 River Walk leases, which generated revenues of about \$674,000<sup>1</sup> in fiscal year (FY) 2009. Of the 37 leases, 33 are for patio and/or air (e.g. balcony) space and four are for interior retail space.

Downtown Operations uses market analyses to set base rental rates. Dugger, Canaday, Grafe, Inc., Real Estate Consultants and Appraisers, conducted the most recent market analysis in June 2006. Recently renewed River Walk leases reflect these rates.

From 2007-2008, Downtown Operations reviewed all lease accounts, recalculated rents, and adjusted invoice amounts as needed. These actions greatly improved the invoicing function. In October 2009, Downtown Operations became solely responsible for the invoicing of River Walk leases.

## Audit Scope and Methodology

The audit scope for the testing of the propriety of billings and payments for leases was October 2007 to September 2009. We expanded the scope of the audit for expired leases (see Appendix A on page 5).

We interviewed personnel from Downtown Operations, Risk Management, and the City Attorney's Office; flowcharted the lease renewal process; and reviewed relevant policies and procedures.

We reviewed insurance requirements specified in the leases and lessee insurance forms for 2009.

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<sup>1</sup> SAP accounting system.

We observed patio spaces used by business owners along the River Walk and compared them to the list of 37 River Walk leases provided by Downtown Operations. We relied on management's assertion of the completeness of the list and the propriety of excluding other businesses along the River Walk.

We also determined if the leases were current, or if any had expired prior to or subsequent to Downtown Operations assuming responsibilities for River Walk leases in October 2006. Additionally, we reviewed recent leases (January 2008-September 2009) to determine if they contained appropriate terms.

We relied on computer-processed data extracted from COSA's SAP accounting system to validate FY2008 and FY2009 monthly invoices and payments. We performed direct tests on the data rather than evaluate the system's general and application controls. Our direct testing included comparing lease terms to the monthly invoices and amounts received. We reviewed the timing of late fees, invoices, and payments. Additionally, we compared lease payment terms to payment terms reflected in SAP. We do not believe that the absence of testing general and application controls had an effect on the results of our audit.

Our testing criteria included clauses in River Walk leases and a 2006 market analysis prepared by Dugger, Canaday, and Grafe, Inc.

We conducted this audit from September 2009 to March 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our audit results and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our audit results and conclusions based on our 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. Non-compliance with Insurance Requirements

Appropriate reviews were not made of lessee insurance coverage.

The lease between COSA and each lessee defines the types and amounts of insurance coverage required. River Walk lessees provide their insurance certificates to Downtown Operations which forwards them to COSA's Risk Management for review. Downtown Operations relies on the expertise of Risk Management to approve certificates of insurance provided by the lessee.

According to Risk Management, insurance requirements in previous City leases contained boilerplate language not tailored to River Walk leases. This boilerplate language is subject to interpretation and can result in the insured buying too much or too little insurance. Risk Management did not consistently compare certificates of insurance from business owners to individual leases; instead, they read the certificates to see if the types and amounts seemed reasonable which resulted in non-compliance with lease insurance requirements.

Because of this audit, Downtown Operations and Risk Management worked together to compare insurance certificates to each of the 37 leases. They determined that insurance coverage was insufficient for 15 of the 37 leases. To correct this condition, Downtown Operations requested corrected endorsements and/or proof of insurance coverage from the 15 businesses. For the other 22 leases, the coverage types were either unnecessary or the amounts were excessive. Consequently, Downtown Operations initiated, and Risk Management approved, formal waivers of coverage for the unnecessary types and excessive amounts.

Two recently written leases lacked a liquor liability requirement. According to Risk Management, the missing insurance requirement was an oversight. If lessees are not required to maintain appropriate insurance coverage types and amounts, the City's potential for liability increases if accidents occur.

**Recommendation:** Downtown Operations should:

- Work with Risk Management to ensure that leases contain appropriate insurance coverage types and amounts needed to protect the City's interests.
- Ensure that each business complies with the insurance requirements of the lease.

## B. Expired Leases

Lease renewals were not timely. Six of the 37 leases expired prior to Downtown Operations assuming responsibility for River Walk leases on October 1, 2006. Another five leases expired between October 1, 2006 and September 30, 2009.

COSA's Procurement Policy and Procedures Manual (contains requirements for revenue contracts), Chapter 7 Contract Administration, states that the renewal process should begin at least four months prior to the lease expiration date. Some of Downtown Operations' leases may take more than four months to renew because the Department may need to obtain a survey and then simultaneously create the lease and boundary line agreement.

It took between 153 and 2,588 days to negotiate new leases for the businesses listed in Appendix A. We did note that since October 1, 2006 when Downtown Operations became responsible for River Walk leases, the average time to negotiate nine new leases was 325 days. We also noted that two properties have been operating with expired leases for more than seven years.

River Walk leases typically state the interim rent to be charged businesses when their leases expire should be between 125% and 200% of the final month's rent stipulated in the expired lease. Although leases had expired, businesses that continued to occupy City owned space were charged the rent that had been in effect instead of an increased interim rent. By written agreement, Downtown Operations may waive the increased interim rent. However, Downtown Operations could not provide written agreements to support this practice.

Late renewals may result in lost revenue to the City. For example, one lessee was charged \$1,200 annually according to a lease that expired in 2002. If the City had renegotiated the lease using rents comparable to contemporaneous leases, the annual rental fees for FY2008 and FY2009 would have been \$20,353 and \$20,903 respectively rather than the \$1,200 actually charged. This represents a loss to the City of \$38,856.<sup>2</sup>

**Recommendation:** Downtown Operations should:

- Begin the renewal process with sufficient lead-time to ensure timely execution of leases.
- Agree upon and document interim rent when a new lease is not negotiated prior to expiration of the existing lease.

*This concludes the Audit Results and Recommendations. Management's responses to the observations will be in Appendix C.*

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<sup>2</sup> The loss represents the difference between the prevailing and actual rents [ $\$20,353 + \$20,903 - (2 * \$1,200)$ ].

## Appendix A – Number of Days Between Leases

No.	Tenant Name	Previous Lease End Date	Current Lease Effective Date	Number of Days Between Leases
1	Boudro's	6/30/2007	1/1/2009	550
2	Dick's Last Resort	7/31/2007	1/1/2008	153
3	Hilton Palacio Del Rio	9/30/2007	7/1/2009	639
4	Homewood Suites	3/31/2002	Not renewed as of 9/30/2009	2,740*
5	Joe's Crab Shack	6/30/2007	1/1/2008	184
6	The Landing	9/30/2001	11/1/2008	2,588
7	Rio Plaza	6/30/2007	7/1/2008	366
8	Rio Rio Cantina <sup>3</sup>	7/31/2002	Not renewed as of 9/30/2009	2,618*
9	Siam Real Estate	12/31/2005	1/1/2007	365
10	Silversmith	12/31/2005	1/1/2007	365
11	Spirit of San Antonio	12/31/2005	1/1/2007	365

\*Calculated as of 9/30/2009 - the end of the audit scope period.

<sup>3</sup> City Council approved a new lease with Rio Rio Cantina effective November 1, 2009.

## **Appendix B – Staff Acknowledgement**

Barry Lipton, CPA, DABFA, Deputy City Auditor  
Mark Bigler, CPA-Utah, CISA, CFE, Audit Manager  
Arlena Sones, CPA, CIA, CGAP, Auditor in Charge  
Rebecca Moulder, CIA, Auditor

## Appendix C – Management Response

**CITY OF SAN ANTONIO  
DOWNTOWN OPERATIONS DEPARTMENT  
INTERDEPARTMENTAL CORRESPONDENCE SHEET**

TO: Park E. Pearson, CPA, City Auditor

FROM: Paula X. Stallcup, Director, Downtown Operations Department

COPIES: Bruce Martin, Contracts Manager

SUBJECT: Management’s Corrective Action Plan for the Audit of Downtown Operations,  
River Walk Leases

DATE: May 3, 2010

Downtown Operations 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
A	<p><b>Non-compliance with Insurance Requirements</b></p> <p>Downtown Operations should:</p> <ul style="list-style-type: none"> <li>• Work with Risk Management to ensure that leases contain appropriate insurance coverage types and amounts needed to protect the City’s interests.</li> <li>• Ensure that each business complies with the insurance requirements of the lease.</li> </ul>	3	Accept	Bruce Martin, Contract Mgr	Ongoing
<p><b>Action plan:</b></p> <ol style="list-style-type: none"> <li>1. Distribute draft leases to Risk Management in order to obtain and insert recommended language based on they type of lease and specific requirements.</li> <li>2. Distribute insurance certificates to Risk Management in order to review and verify adequate insurance coverage required for the lease.</li> </ol>					

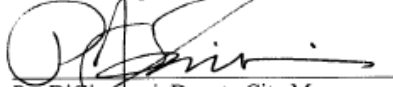
Recommendation					
#	Description	Audit Report Page	Accept, Partially Accept, Decline	Responsible Person's Name/Title	Completion Date
B	<p><b>Expired Leases</b></p> <p>Downtown Operations should:</p> <ul style="list-style-type: none"> <li>• Begin the renewal process with sufficient lead-time to ensure timely execution of leases.</li> <li>• Agree upon and document interim rent when a new lease is not negotiated prior to expiration of the existing lease.</li> </ul>	4	Accept	Bruce Martin, Contract Mgr	Ongoing
<p><b>Action plan:</b></p> <ul style="list-style-type: none"> <li>▪ Forecast lease renewals as part of annual planning process.</li> <li>▪ Incorporate a standard rate in lease agreements and document as necessary.</li> </ul>					

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

Sincerely,

  
Paula X. Stallcup, Director  
Downtown Operations Department

5/3/10  
Date

  
Pat DiCiovanni, Deputy City Manager  
City Manager's Office

5/5/10  
Date