CITY OF SAN ANTONIO

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May 16, 2008

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Mayor and Council Members:

SUBJECT: Lease Management Audit Report

We are pleased to send you the audit report of lease management in the Departments of Asset Management and Downtown Operations. This audit began in August 2007 and concluded with an exit meeting with department management in March 2008. Management's response is included in the Appendix of the report, which states acceptance of the three recommendations made in the audit report. The Departments of Asset Management and Downtown Operations should be commended for their cooperation and assistance during this audit.

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

Respectfully submitted,

Barry Lipton, CPA, DABFA
Deputy City Auditor

Distribution:

Sheryl L. Sculley, City Manager
Pat DiGiovanni, Deputy City Manager
Penny Postoak Ferguson, Assistant City Manager
Paula Stallcup, Director, Downtown Operations
Mike Frisbie, Director, Capital Improvements Management Services
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CITY OF SAN ANTONIO

OFFICE OF THE CITY AUDITOR

Barry Lipton, CPA, DABFA
Deputy City Auditor

Audit of Lease Management in the Departments of Asset Management and Downtown Operations

Project No. AU07-015

Issue Date: May 16, 2008

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EXECUTIVE SUMMARY

As part of our annual risk assessment, we audited the Departments of Asset Management and Downtown Operations, specifically the management of office space leases.

We conducted the audit to determine if:

1. The City receives a fair market rental rate for office space it leases to others.
2. The City incurs excessive costs in maintaining office space it leases to others.
3. The City pays a fair market value for office space it leases from others.

RESULTS IN BRIEF

Overall, we determined the City is exercising sound business practices in the area of lease management. Nevertheless, there are areas that need improvement.

1. The City is receiving a fair market rental rate for office space it leases to others. However, we identified issues related to the Master Lease and Funding Agreement with Centro Alameda, Inc. (CAI). Specifically:
   - The City's contract administration personnel did not account for all expenditures related to the restoration and renovation at the Alameda Theater Complex (Complex), resulting in a $91,718 over-estimate of remaining funds available for renovations.
   - Contract administrators did not enforce all reporting requirements of the Master Lease and Funding Agreement with CAI for the Complex.
2. The City does not incur excessive costs in maintaining office space it leases to others.
3. The City pays a fair market rate for office space it leases from others.

RECOMMENDATIONS

We recommend Downtown Operations:

1. Reduce the amount reported as available for restoration and renovation at the Complex by $91,718.
2. Enhance monitoring of the Master Lease and enforce Lease terms.
3. Enhance monitoring of the Funding Agreement and enforce Agreement terms.

Downtown Operations Management concurs with the audit report. Their response is in the Appendix beginning on page 8.

INTRODUCTION

In 1994, the City purchased the Alameda Theater Complex (Complex) for the purpose of preservation and reuse of historic structures. Subsequently in 1998, the City entered into a Master Lease and a Capital Improvements Funding Agreement with Centro Alameda Inc. (CAI). The Master Lease authorizes CAI to occupy, manage and renovate the Complex. In addition, the Master Lease requires CAI to raise funds in the private sector; however, the Master Lease does not specify the amount. The Funding Agreement specifies procedures to reimburse CAI for restoration and renovation expenses at the Complex. From 1996 to 2001, City Council approved a total of $6,028,700 in certificates of obligation and other contributions to CAI for restoration and renovation costs at the Complex.

Prior to October 2006, Asset Management was responsible for managing the Master Lease and Funding Agreement with CAI. Effective October 1, 2006, City management assigned the responsibility of managing the Master Lease and Funding Agreement to Downtown Operations.

OBJECTIVES, SCOPE, AND METHODOLOGY

As part of our annual risk assessment, we audited the Departments of Asset Management and Downtown Operations, specifically the management of office space leases.

We conducted the audit to determine if:

1. The City receives a fair market rental rate for office space it leases to others.
2. The City incurs excessive costs in maintaining office space it leases to others.
3. The City pays a fair market value for office space it leases from others.

The scope of the audit was October 1998 through July 2007.

We reviewed all lease agreements and City ordinances related to office space leases. We verified the accuracy and proper recording of lease receipts and payments. We also compared the City's rental rates with current fair market rates for leases and operating costs. We interviewed staff and management personnel in the City departments of Asset Management, Downtown Operations, Community Initiatives, Aviation, Office of Cultural Affairs, and Risk Management. We also interviewed CAI personnel. We based our testing criteria on market information for the San Antonio area from the New America International Real Estate Operating Company Partners, the Business Owners and Managers Association, the City of San Antonio Contracting Policy and Process Manual, and Asset Management departmental procedures.

We conducted this audit from August 2007 to April 2008 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 findings and conclusions based on our audit objectives. We believe that

the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit included tests of internal controls that we considered necessary under the circumstances.

CONCLUSIONS

Overall, we determined the City is exercising sound business practices in the area of lease management. Nevertheless, there are areas that need improvement.

1. The City is receiving a fair market rental rate for office space it leases to others. However, we identified issues related to the Master Lease and Funding Agreement with Centro Alameda, Inc. (CAI). Specifically:
   - The City's contract administration personnel did not account for all expenditures related to the restoration and renovation at the Alameda Theater Complex (Complex), resulting in a $91,718 over-estimate of remaining funds available for renovations.
   - Contract administrators did not enforce all reporting requirements of the Master Lease and Funding Agreement with CAI for the Complex.
2. The City does not incur excessive costs in maintaining office space it leases to others.
3. The City pays a fair market rate for office space it leases from others.

STAFF ACKNOWLEDGEMENT

Theresa Cameron, CPA, CIA, Audit Manager
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Rosalia Vielma

OBSERVATION AND RECOMMENDATIONS

OBSERVATION A – Master Lease and Funding Agreement with Centro Alameda, Inc.

A.1 The City did not include reimbursements of $91,718 to Centro Alameda Inc. (CAI) in the total amount drawn from available funding. Accurate accounting is required for appropriate management of the City's contracts and funding obligations. This condition occurred because the City's contract administration personnel did not properly deduct all expenditures from funds approved by City Council. Because of the inaccurate accounting, the City shows $2,239,164 as funds available to CAI; the actual amount of available funds is $2,147,446. Table A summarizes funding approved and paid to CAI for the restoration of the Complex and shows the actual remaining funds available as $2,147,446.

Table A

Line	Alameda Theater Complex Funding 1996 – 2001	
1	Total Funds Approved by City Council	$6,028,700
2	Reported Amount of Funds Available	**2,239,164**
3	Reported Amount Reimbursed to CAI	3,789,536
4	Actual Amount Reimbursed to CAI	3,881,254
5	Difference	(91,718)
6	Actual Funds Available (Line 1 less Line 4)	**$2,147,446**

A.2 City contract administrators did not enforce all reporting requirements of the Master Lease with CAI. Specifically:

Semi-annual progress reports

- CAI submitted six of the 15 semi-annual reports 2 to 10 months late.

Annual progress reports

- CAI did not submit three of the nine required annual progress reports from October 1, 1998 through December 31, 2007: those due for fiscal years 1999, 2006, and 2007.
- CAI submitted three of the six annual progress reports 1 to 9 months late
- CAI did not have an independent CPA attest to four of the six annual progress reports submitted and the CPA attestation for 2004 did not meet all reporting requirements.

The Master Lease requires CAI to submit semi-annual and annual progress reports that quantify CAI's fund-raising efforts, amounts spent on renovation construction, and include an income statement with total earned income and operating expenses. The semi-annual reports are due to City Management 10 days after the end of each six-

month reporting period. Annual progress reports are due to City Management within 90 days after the end of CAI's fiscal year. In addition, an independent Certified Public Accountant (CPA) must attest to the annual progress reports. Incomplete and untimely reporting occurred because CAI did not respond to multiple requests from City contract administration personnel. As a result, contract administrators did not have sufficient information to determine whether CAI owed rent to the City or if CAI complied with all terms of the Master Lease. According to the Master Lease, CAI owes rent to the City when their earned income exceeds operating expenses by ten percent.

A.3 City contract administrators did not enforce all reporting requirements of the Funding Agreement. Specifically:

- Audited financial statements CAI submitted from October 1, 1998 through December 31, 2002 did not include the required schedules or certifications by CAI management in connection with fund reimbursements received from the City.

The Funding Agreement requires CAI to provide audited financial statements prepared by an independent CPA within 90 days after the end of CAI's fiscal year. The audited financial statements must include a supplemental schedule of receipts and disbursements of City funds by budgeted cost category and a certification from CAI stating whether it met the terms and conditions of the Funding Agreement. Incomplete and untimely reporting occurred because CAI did not respond to multiple requests from contract administration personnel. As a result, contract administrators did not have sufficient information to determine whether CAI complied with all terms of the Funding Agreement.

RECOMMENDATIONS

We recommend Downtown Operations:

A.1 Reduce the amount reported as available for restoration and renovation at the Complex by $91,718.

A.2 Enhance monitoring of the Master Lease and enforce Lease terms.

A.3 Enhance monitoring of the Funding Agreement and enforce Agreement terms.

APPENDIX – Management Response

CITY OF SAN ANTONIO
SAN ANTONIO TEXAS 78283-3966

May 9, 2008

TO: Barry Lipton, Deputy City Auditor

FROM: Paula Stallcup, Director, Downtown Operations Department

RE: Management's Corrective Action Plan for the Audit of Lease Management in the Departments of Asset Management and Downtown Operations.

Downtown Operations Management has reviewed the Lease audit report and has developed the Corrective Action Plans below corresponding to report recommendations. The Funding Agreement for Centro Alameda, Inc. supports renovations to the Theatre Complex.

Recommendation					
#	**Description**	**Audit Report Page**	**Accept, Partially Accept, Decline**	**Responsible Person's Name/Title**	**Completion Date**
A	Master Lease with Centro Alameda, Inc. (1998-2023 with 25 year renewal)	**5**			
A.1	Reduce the amount reported as available for restoration and renovation at the Complex in the Funding Agreement by $91,718. Disbursements were made from 1998 through 2002.	**6**	Accept	Mary Yturri Contract Coordinator	Formal notice sent to CAI on 4/14/08
A.2	Enhance monitoring of the Master Lease and enforce Lease terms.	**6**	Accept	Mary Yturri Contract Coordinator	Throughout Term + Renewals
A.3	Enhance monitoring of the Funding Agreement and enforce Agreement terms.	**6**	Accept	Mary Yturri Contract Coordinator	Throughout Term + Renewals
	Action plan: A.1 Written notice regarding reduced amount was sent to CAI on 4/14/08. Last disbursement made to CAI per funding agreement was dated 3/12/02. A.2 Enhance monitoring to ensure timely receipt of semi-annual and annual progress reports and annual progress report attestation. Meet with CAI quarterly to review reporting and ensure compliance. A.3 Enhance monitoring to ensure timely receipt of annual audited financial statements. Meet with CAI quarterly to review reporting and ensure compliance.				

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

Paula X. Stallcup
Director
Downtown Operations Department

Penny Postoak Ferguson
Assistant City Manager
City Manager's Office