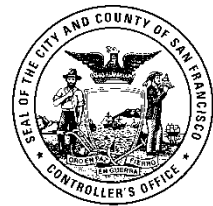


### **AIRPORT COMMISSION:**

**The Airport Needs to Enhance  
Procedures Over Tenants' Build-out  
Close-out Compliance**



May 17, 2012

**OFFICE OF THE CONTROLLER  
CITY SERVICES AUDITOR**

The City Services Auditor Division (CSA) was created in the Office of the Controller through an amendment to the Charter of the City and County of San Francisco (City) approved by voters in November 2003. Under charter Appendix F, CSA has broad authority to:

- Report on the level and effectiveness of San Francisco's public services and benchmark the city to other public agencies and jurisdictions.
- Conduct financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operate a whistleblower hotline and website and investigate reports of waste, fraud, and abuse of city resources.
- Ensure the financial integrity and improve the overall performance and efficiency of city government.

CSA may conduct financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

CSA conducts its audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

For questions regarding the report, please contact Tonia Lediju at [Tonia.Lediju@sfgov.org](mailto:Tonia.Lediju@sfgov.org) or 415-554-5393, or CSA at 415-554-7469.

Audit Team: Mark de la Rosa, Audit Manager  
Helen Vo, Associate Auditor



# City and County of San Francisco

## Office of the Controller - City Services Auditor

**Airport Commission:**

**May 17, 2012**

**The Airport Needs to Enhance Procedures Over Tenants' Build-out Close-out Compliance**

### Purpose of the Audit

The Airport Commission (Airport) requested the City Services Auditor Division (CSA) of the Office of the Controller to audit the Airport's Terminal 2 build-out close-out procedures as administered by the Airport's Revenue Development and Management unit. This audit determined whether the concession tenants of San Francisco International Airport's Terminal 2 complied with the build-out close-out requirements of the Airport, and assessed the effectiveness of the Airport's build-out close-out policies and procedures.

### Highlights

The Airport's procedures for collecting and tracking minimum investment amount (MIA) supporting documentation and as-built drawings do not sufficiently ensure that Terminal 2 tenants comply with build-out close-out requirements. Collecting accurate, complete, and timely build-out close-out documents would help assure the Airport that its tenants comply with relevant requirements and, more importantly, would assist the Airport in making tenant buy-out decisions in the future. The audit found that:

- Two (13 percent) of the 16 tenants did not meet the MIA requirement, resulting in a deficiency of \$227,269 that is owed to the Airport.
- Twelve (75 percent) of the 16 tenants submitted MIA documentation that did not adequately support the reported construction costs. Because more than \$5.1 million in costs are associated with these inadequate documents, over half of the \$10.1 million in reported construction costs would be based on inadequate support if the Airport were to buy out the space of these 12 concession tenants based on available information.
- The Airport insufficiently instructs tenants about MIA document submittals and does not validate the accuracy, completeness, and timeliness of MIA documents.
- Eleven (52 percent) of the 21 businesses have not complied with the as-built drawing requirements, and all but one of the businesses that had as-built drawings due submitted them late. On average, these drawings were received almost three months late.
- The Airport's procedures for collecting and tracking as-built drawings need improvements. For example, the leases do not explicitly require the submittal of as-built drawings, and the Airport does not clearly identify the entity responsible for monitoring that as-built drawings are submitted.

### Recommendations

The audit report includes 21 recommendations for the Airport to ensure tenants' build-out close-out compliance. Key recommendations include that the Airport should:

- Collect deficiencies totaling \$227,269 from two tenants.
- Require 12 tenants to submit adequate supporting documents that substantiate their construction costs.
- Develop instructions that require all tenants to submit MIA supporting documents that directly support the reported total construction costs.
- Require the 11 non-compliant businesses to submit as-built drawings in the correct format.
- Explicitly include as-built drawing requirements in future tenant leases.
- Develop and implement clear policies and procedures for collecting and tracking as-built drawings.

*Copies of the full report may be obtained at:*

*Controller's Office • City Hall, Room 316 • 1 Dr. Carlton B. Goodlett Place • San Francisco, CA 94102 • 415.554.7500  
or on the Internet at <http://www.sfgov.org/controller>*

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**CITY AND COUNTY OF SAN FRANCISCO**  
**OFFICE OF THE CONTROLLER**

**Ben Rosenfield**  
**Controller**

**Monique Zmuda**  
**Deputy Controller**

May 17, 2012

Airport Commission  
San Francisco International Airport  
P.O. Box 8097  
San Francisco, CA 94128-8097

John L. Martin  
Director  
San Francisco International Airport  
P.O. Box 8097  
San Francisco, CA 94128-8097

Dear Commission President Mazzola, Commissioners, and Mr. Martin:

The Office of the Controller's City Services Auditor Division (CSA) presents its audit report of the build-out close-out procedures related to the renovation of San Francisco International Airport's Terminal 2, completed in April 2011. The audit objectives were to determine the compliance of Terminal 2 tenants with build-out close-out requirements, specifically those regarding the minimum investment amount and as-built drawings, and to assess the effectiveness of the build-out close-out procedures as administered by the Revenue Development and Management unit of the Airport Commission (Airport).

The audit concluded that the Airport's procedures for collecting, reviewing and tracking minimum investment amount supporting documentation and as-built drawings do not sufficiently ensure Terminal 2 tenants' compliance with build-out close-out requirements.

The audit report includes 21 recommendations for the Airport to ensure tenants' build-out close-out compliance. The Airport's response to the audit report is attached as an appendix. CSA will work with the Airport to follow up on the status of the recommendations made in this report.

CSA appreciates the assistance and cooperation that Airport staff provided to us during the audit. For questions regarding the report, please contact me at [Tonia.Lediju@sfgov.org](mailto:Tonia.Lediju@sfgov.org) or 415-554-5393, or CSA at 415-554-7469.

Respectfully,

A handwritten signature in black ink, appearing to read "Tonia Lediju", written over a light blue horizontal line.

Tonia Lediju  
Director of Audits

cc: Mayor  
Board of Supervisors  
Civil Grand Jury  
Budget Analyst  
Public Library

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## **GLOSSARY OF TERMS**

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Airport	Airport Commission
City	City and County of San Francisco
CSA	City Services Auditor Division of the Office of the Controller
BICE	Building Inspection and Code Enforcement unit of the Airport
MIA	Minimum Investment Amount
RDM	Revenue Development and Management unit of the Airport



## INTRODUCTION

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### Audit Authority

The Airport Commission (Airport) requested the City Services Auditor Division (CSA) of the Office of the Controller to audit the Airport's Terminal 2 build-out close-out procedures. Collecting accurate and complete build-out<sup>1</sup> close-out documentation is important because the Airport may need to buy out a tenant in the future and, if it does, must do so based on available construction cost<sup>2</sup> and as-built information. This audit was conducted under the authority of the Charter of the City and County of San Francisco (City), Section 3.105 and Appendix F, which requires CSA to conduct periodic, comprehensive financial and performance audits of city departments, services and activities.

### Background

*The Terminal 2 renovation was completed in April 2011.*

Terminal 2, first opened in 1954 as Central Terminal, was renovated in 1983 to accommodate international flights. When the Airport opened the current International Terminal in 2000, Central Terminal was renamed Terminal 2 and was used primarily for administrative offices. The Airport began the latest renovation of Terminal 2 in 2008 and completed the \$383 million renovation in April 2011. Offering 640,000 square feet, Terminal 2 is the newest domestic terminal and home to American Airlines and Virgin America.

*Terminal 2 has 21 concession locations.*

Terminal 2 houses 21 concession locations rented under 8 food and beverage leases and 8 retail leases. Exhibit 1 lists the 16 Terminal 2 concession leases awarded by the Airport and Exhibit 2 is a map of Terminal 2 concession locations.

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<sup>1</sup> For the purposes of this audit, build-out is defined as the development or expansion of tenant spaces at Terminal 2.

<sup>2</sup> Construction costs include construction hard costs, architectural/engineering costs, and furniture, furnishings and equipment costs.

Office of the Controller, City Services Auditor  
**The Airport Needs to Enhance Procedures Over Tenants' Build-out Close-out Compliance**

**EXHIBIT 1**

**Terminal 2 Concession Tenants and Businesses They Operate**

Tenant	Lease Number	Square Feet	Business Operated
<b>FOOD &amp; BEVERAGE LEASES</b>			
1. D-Lew Enterprises, LLC	10-0029	4,995	1. Napa Farms Market 2. Vino Volo
2. Gotham Enterprises, LLC	10-0030	1,227	3. Peet's Coffee and Tea
3. HBF Soto JV, LLC	10-0031	1,975	4. Cat Cora
4. D-Lew Enterprises, LLC	10-0032	3,958	5. Lark Creek Grill
5. Sankaku, Inc.	10-0033	911	6. Wakaba Sushi & Noodle
6. Andale Management Group, Inc.	10-0034	1,066	7. Andale
7. BJ Annex, LLC	10-0035	1,072	8. Burger Joint
8. HBF Soto JV, LLC	10-0036	906	9. The Plant Café Organic & Pinkberry
<b>RETAIL LEASES</b>			
9. Books, Inc.	10-0037	2,994	10. Compass Books
10. Edge 1 Cellular, LP	10-0038	1,350	11. I-Tech X-perience
11. Avila Retail Development & Management, LLC	10-0039	1,597	12. Mosaic Fine Art and Craft Gallery
12. Avila Retail Development & Management, LLC	10-0040	765	13. Greetings from San Francisco
13. XpresSpa S.F. International, LLC	10-0041	2,031	14. XpresSpa
14. RDG Concessions, LLC	10-0043	740	15. Pacific Outfitters
15. Host International, Inc.	10-0232	4,420	16. Starbucks 17. Mango 18. Kiehl's 19. Sunset News 20. SFO News Express
16. Melshire DFW, L.P.	10-0313	928	21. Natalie's Candy Jar

Source: Auditor's review of Terminal 2 concession leases.

**EXHIBIT 2 Terminal 2 Concession Map**



Source: Airport's website.

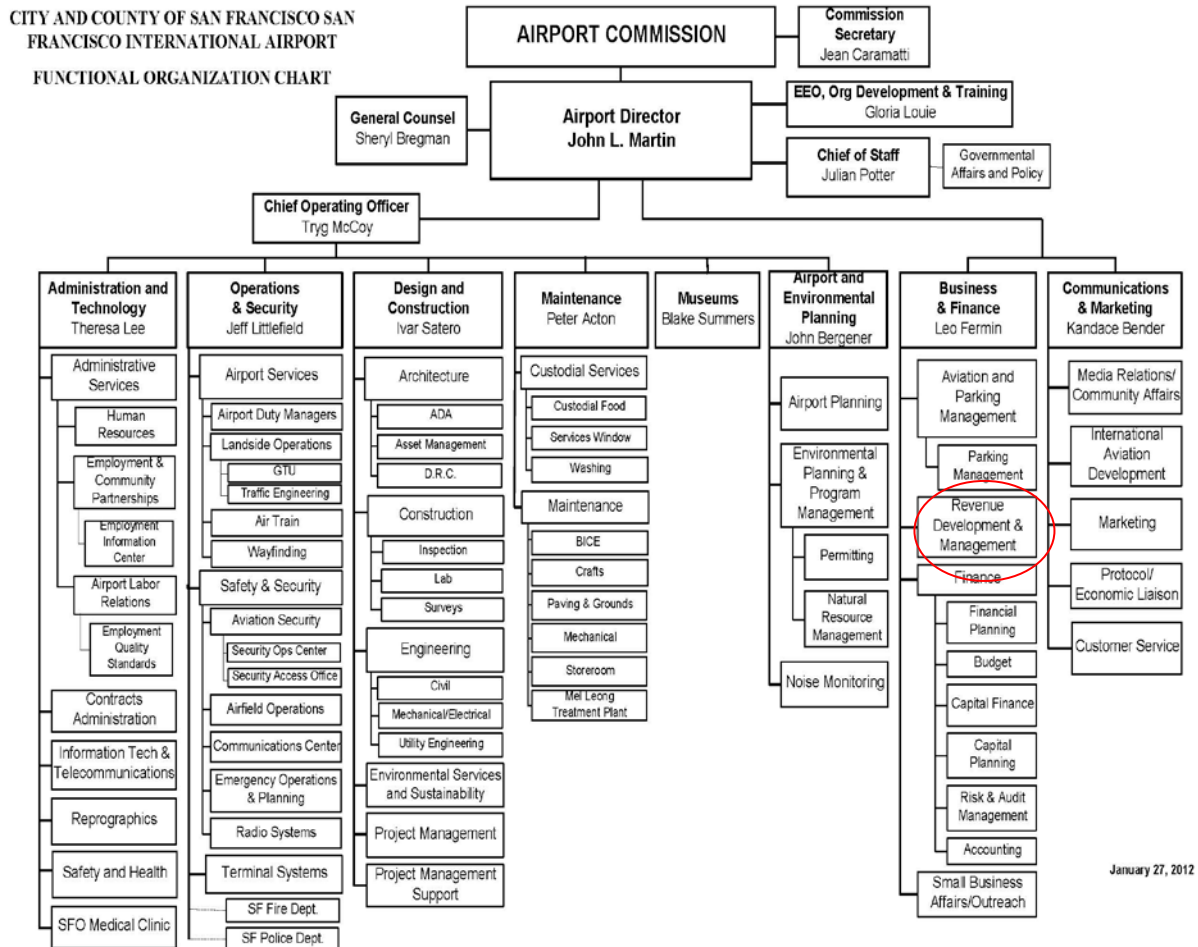
*The Airport's Revenue Development and Management unit manages concession leases.*

Concession tenant leases are administered by the Airport's Revenue Development and Management unit (RDM), which is within the Airport's Business and Finance Division. RDM manages all retail, food and beverage, rental car, and passenger services leases at San Francisco International Airport. RDM also develops and sets the policies and guidelines in these tenant leases.

RDM manages leases and permits covering 187 retail locations, numerous vending, advertising, pay phone, cart, and automated teller machine locations, and a rental car center. Tenants managed by RDM generated \$727 million in sales and \$135 million in revenue to the Airport in fiscal year 2010-11. The Airport's rental revenue from concession tenants is based on a percentage of the tenants' sales.

RDM has 16 staff: 1 associate deputy airport director, 3 senior principal property managers, 8 principal property managers, and 4 administrative staff. The Airport's organization chart, Exhibit 3, shows RDM's placement.

**EXHIBIT 3 Airport Organization Chart**



Source: Airport.

**Objectives**

The objectives of this audit were to:

1. Determine the compliance of Terminal 2 tenants with the Airport's build-out close-out requirements, specifically those concerning minimum investment amount (MIA) and as-built drawings.
2. Determine the effectiveness of the Airport's build-out

close-out policies and procedures.

**Scope and Methodology**

The audit focused on Terminal 2's food and beverage leases and retail leases. The audit considered RDM's structure and operations for the period November 1, 2010, through September 30, 2011.

To conduct the audit, the audit team:

- Reviewed key documents, policies, and procedures relating to RDM's build-out close-out process.
- Interviewed key personnel from RDM and the Airport's Business and Finance Division and Building Inspection and Code Enforcement unit (BICE).
- Reviewed all Terminal 2 food and beverage and retail leases.
- Reviewed close-out documentation submitted by Terminal 2 tenants relating to MIA and as-built drawing requirements.
- Contacted comparable jurisdictions and reviewed best practices literature for relevant information on build-out close-out requirements and procedures.

**Statement of Auditing Standards**

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. CSA believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

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# CHAPTER 1 – Airport Procedures Do Not Ensure Tenants' Minimum Investment Amount Compliance

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## Summary

The Airport's procedures for collecting and tracking MIA supporting documentation do not sufficiently ensure tenant compliance with MIA requirements. For example, two of the 16 tenants did not meet the MIA requirement, resulting in a deficiency of \$227,269 that is owed to the Airport. In addition, 12 of the 16 tenants submitted MIA documentation that did not adequately support their reported construction costs. Because over \$5.1 million in costs are associated with these inadequate documents, more than half of the \$10.1 million in reported construction costs would be based on inadequate support if the Airport were to buy out the space of these 12 concession tenants based on available information. These inadequate documents are attributable to RDM not providing sufficient tenant instructions and not validating the accuracy, completeness, and timeliness of MIA submittals. Implementing clear procedures for collecting accurate and complete MIA supporting documents will help assure the Airport that tenants have met its standards for refurbishing and modernizing Airport premises and, more importantly, that the Airport has adequate information to appropriately base its tenant buy-out decisions in the future.

## Finding 1.1

**Two of the 16 tenants did not meet the MIA requirement, resulting in a deficiency of \$227,269.**

*Two tenants did not meet the MIA requirement.*

Of the 16 Terminal 2 concession tenants, 2 (13 percent) did not meet the MIA requirement specified in their lease agreements, resulting in a deficiency of \$227,269 that is owed to the Airport, as detailed in Exhibit 4.

EXHIBIT 4	Minimum Investment Amount Deficiencies of Terminal 2 Tenants			
Tenant	Contract	MIA Requirement per Lease	Actual Investment Cost	Deficiency
Books, Inc.	10-0037	\$1,047,900	\$861,535	\$186,365
Edge 1 Cellular, L.P.	10-0038	472,500	431,596	40,904
Total				\$227,269

Source: Auditor's analysis of leases and affidavits submitted to Airport.

*MIA language in the body and summary of some leases is inconsistent.*

The summary pages of all 16 leases indicate that tenants may spend less than \$350 per square foot if the build-out complies with the Terminal 2 Concessions Design Guidelines and receives Design Review Committee approval. However, this waiver of the MIA is not in the body of the leases of the two tenants included in Exhibit 4. Instead, the relevant sections in these two leases state that if the actual investment cost is determined to be less than the MIA, the deficiency will be paid to the City within 60 days after completion of construction. According to the leases, in the event of any inconsistency between the lease summary and the provisions of the lease, the provision of the lease (i.e., the body of the lease) shall prevail. As such, Books, Inc., and Edge 1 Cellular, L.P., did not meet the MIA requirement and, therefore, owe the deficiencies to the City.

According to RDM staff, they did not require the two tenants to pay the deficiency payments primarily because of the waiver clause in the lease summary. Using consistent language in the body and summary of each lease would ensure clarity and consistency in the application of lease provisions.

*The MIA is intended to ensure that tenants construct premises at a high level of quality.*

Terminal 2 concession leases required tenants to refurbish, redecorate, and modernize their premises before the terminal opened. The leases also require the construction costs for the build-out of the premises to meet or exceed an MIA, which is calculated by multiplying the number of square feet by \$350, regardless of the type of concession or size of the leased space. The MIA is intended to ensure that tenants construct premises at a level of quality expected by the Airport. Collecting complete and accurate MIA documentation is important not only to ensure that the tenant meets the requirement, but because the Airport may need to buy out the tenant in the future and will need to do so based on available construction cost information.

## **Recommendations**

The Airport should:

1. Collect the deficiencies totaling \$227,269 from Books, Inc., (\$186,365) and Edge 1 Cellular, L.P., (\$40,904) for not meeting the minimum investment amount requirement in their lease agreements.
2. Use consistent language in the bodies and summaries



of tenant lease agreements to ensure clarity and consistency in the application of lease provisions.

**Finding 1.2**

**Most tenants submitted MIA documentation that did not adequately support reported construction costs.**

*75 percent of tenants submitted MIA documentation that inadequately supports reported construction costs.*

Of the 16 tenants, 12 (75 percent) submitted inadequate MIA supporting documents, including one tenant that did not submit any supporting documents. The audit deemed these 12 tenants to have submitted inadequate supporting documents because at least some of the documents they submitted either were not paid invoices or lien waivers, as required by the lease agreements, or did not tie directly or clearly to the reported construction costs. The costs associated with these inadequate documents totaled over \$5.1 million, which means that if the Airport were to buy out these 12 concession tenants, which reported a cumulative total construction costs of \$10.1 million, over half of these reported costs would be based on inadequate supporting documents.

Only 3 (19 percent) of the 16 tenants submitted MIA documentation that adequately supported the reported construction costs.<sup>3</sup> One tenant submitted adequate supporting documentation, but its reported construction costs were below the MIA required by its lease. Exhibit 5 details Terminal 2 tenants' compliance with the MIA requirement and the adequacy of supporting documentation.

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<sup>3</sup> Adequate supporting documents are those that clearly and directly substantiate the construction costs listed on the tenants' affidavits.

**EXHIBIT 5**

**Minimum Investment Amount Compliance and Supporting Documentation of Terminal 2 Tenants**

Tenant & Contract Number	MIA per Lease	Cost per Affidavit	Cost per Supporting Documents	Difference Between Affidavit & Lease	Difference Between Supporting Documents and Affidavit
<b>Submitted Adequate Support and Met MIA</b>					
1. D-Lew Enterprises, LLC (10-0029)	\$1,748,250	\$2,131,719	\$2,131,720	\$383,469	\$ 1
2. D-Lew Enterprises, LLC (10-0032)	1,385,300	1,984,080	1,984,080	598,780	-
3. HBF Soto JV, LLC (10-0031)	691,250	2,095,588	2,807,028	1,404,338	711,440
<b>Subtotal</b>	<b>3,824,800</b>	<b>6,211,387</b>	<b>6,922,828</b>	<b>2,386,587</b>	<b>711,441</b>
<b>Submitted Adequate Support but Did Not Meet MIA</b>					
4. Edge 1 Cellular, LP (10-0038)	472,500	431,596	467,427	(40,904)	35,831 <sup>d</sup>
<b>Subtotal</b>	<b>472,500</b>	<b>431,596</b>	<b>467,427</b>	<b>(40,904)</b>	<b>35,831</b>
<b>Submitted Inadequate Support</b>					
5. Gotham Enterprises, LLC (10-0030)	429,450	985,269	647,816	555,819	(337,453) <sup>c</sup>
6. Sankaku, Inc. (10-0033)	318,850	804,331	746,908	485,481	(57,423) <sup>c</sup>
7. Andale Management Group, Inc. (10-0034)	373,100	933,838	635,288	560,738	(298,550) <sup>c</sup>
8. BJ Annex, LLC (10-0035)	375,200	921,378	229,945	546,178	(691,433) <sup>c</sup>
9. HBF Soto JV, LLC (10-0036)	317,100	1,197,147	1,113,672	880,047	(83,475) <sup>c</sup>
10. Books, Inc. (10-0037)	1,047,900	861,535	800,227	(186,365)	(61,308) <sup>c</sup>
11. Avila Retail Development & Management, LLC (10-0039)	558,950	598,608	216,498	39,658	(382,110) <sup>c</sup>
12. Avila Retail Development & Management, LLC (10-0040)	267,750	339,466	129,694	71,716	(209,772) <sup>c</sup>
13. RDG Concessions, LLC (10-0043)	259,000	352,831	267,359	93,831	(85,472) <sup>c</sup>
14. Host International, Inc. (10-0232)	1,547,000	2,096,301	- <sup>b</sup>	549,301	(2,096,301) <sup>c</sup>
15. Melshire DFW, L.P. d/b/a Natalie's Candy Jar (10-0313)	324,800	442,487	227,894	117,687	(214,593) <sup>c</sup>
16. XpresSpa S.F. International, LLC (10-0041)	710,850	602,563	- <sup>a</sup>	(108,287)	(602,563) <sup>a</sup>
<b>Subtotal</b>	<b>\$6,529,950</b>	<b>\$10,135,754</b>	<b>\$5,015,301</b>	<b>\$3,605,804</b>	<b>\$(5,120,453)</b>

Notes:

<sup>a</sup> Tenant did not submit supporting documentation with affidavit.

<sup>b</sup> None of the documents submitted by tenant clearly and directly substantiate the construction costs listed on the affidavits.

<sup>c</sup> Supporting documents do not adequately support all construction costs on the affidavits.

<sup>d</sup> Supporting documents generally adequate, given magnitude of the difference compared to MIA requirement.

Source: Auditor analysis of tenant affidavits and supporting documents provided by Airport.

Some examples of the \$5.1 million of inadequate MIA supporting documents submitted by Terminal 2 tenants include:

*Many tenants submitted documentation that was neither a paid invoice nor a lien waiver, contrary to their leases.*

- *Documents Other Than Invoices and Lien Waivers:* Many of the tenants' MIA supporting documents are inadequate because they are neither paid invoices nor lien waivers. Such documents include contracts, proposals, or quotes, which do not show the actual cost or amount billed to the tenant and, therefore, only minimally assure RDM of the actual construction cost paid by the tenant.

*Some costs included in the supporting documentation appear to be inappropriate and unallowable.*

- *Documents Containing Potentially Inappropriate or Unallowable Costs:* Some documented costs may not be appropriate or allowable as they appear to be unrelated to refurbishing, redecorating, or modernizing the Terminal 2 premises. Including unallowable expenses would inflate reported construction costs and, therefore, cause inaccurate assessments of tenants' MIA compliance. For example, one tenant, Edge 1 Cellular, L.P., submitted several documents that contained potentially unallowable or inappropriate costs, including:
  - A \$20,000 bonus fee paid by the tenant to a consultant for the awarding of the Terminal 2 contract to the tenant.
  - A \$2,500 payment to the Airport for sponsoring the Airport's Terminal 2 re-opening celebrations.
  - Four invoices totaling \$2,332 for legal fees the tenant incurred for services pertaining to student loans, demand letters, refinancing, and a property sale.

In addition, Avila Retail Development & Management, LLC, which has two leases at Terminal 2, submitted \$8,625 of invoices for items that were delivered to an address in New Mexico, including items such as iPod nanos, computers, and printers. While these items could relate to the tenant's build-out at Terminal 2, it was unclear from the documentation how. It was also unclear why they were delivered to New Mexico instead of the tenant's local address.

*One tenant submitted invoices in a foreign language.*

- *Documents in a Foreign Language:* One tenant, Sankaku, Inc., submitted three invoices in Japanese as supporting documents, making it difficult for the Airport and auditors to assess their appropriateness or relevance. Although purchases made abroad may be billed in a foreign language, requiring tenants to document in English the key pieces of information (e.g., description of purchases, prices, and dates) would allow RDM to validate and confirm construction costs.

*RDM's MIA supporting document instructions do not align with lease requirements and do not provide sufficient details to tenants.*

Inadequate support from tenants is the result of RDM's inadequate instructions on MIA supporting documents. The instructions provided to the tenants do not align with the lease requirements and do not provide sufficient details. According to the leases, the tenant must provide to the City an affidavit stating the construction costs paid by the tenant, together with copies of paid invoices and lien waivers substantiating the costs stated in the affidavit. The leases also state that construction costs may include architectural and engineering fees and may not include financial costs, interest, inventory, pre-opening expenses, intercompany charges related to construction, business interruption, overhead or debt service on any construction loan, or any charges paid by tenant to an affiliate.

RDM's notification letter includes an affidavit form which asks tenants to provide basic information about themselves and the construction costs, in three categories:

- Construction hard costs
- Architectural/engineering costs
- Furniture, furnishings, and equipment costs

*RDM's notification letter lacks sufficient detail on what tenants must submit.*

However, the notification letter does not mention that the attachments to support these costs should include paid invoices and lien wavers, as required in the lease. In addition, RDM only instructs its tenants to "provide the necessary attachments" and does not provide sufficient details regarding submitting supporting documents that:

- Directly tie to the reported total construction costs.
- Contain appropriate and allowable costs.
- Are well-organized to enable quick and easy review by RDM.

Developing clear policies and procedures on the

characteristics and quality of supporting documentation would help RDM ensure that tenants submit accurate and complete supporting documentation and that tenants comply with the Airport's standard of quality for refurbishing, redecorating, and modernizing Airport premises.

*D-Lew Enterprises, LLC, provided well-organized supporting documents, which should be a model for what is required.*

D-Lew Enterprises, LLC, which has two leases at Terminal 2, submitted well-organized supporting documents, enabling quick and easy review to assess the completeness and appropriateness of invoices submitted. For example, this tenant provided:

- Summaries that listed all of the construction cost invoices submitted grouped by the three cost categories.
- Summed amounts for the invoices, which tied directly to the construction costs reported in the affidavit.
- Supporting documents arranged by cost category and submitted in the order in which they were listed in the summary.

If every tenant organized and summarized its supporting documents in these ways, RDM would be able to quickly and easily conclude whether the tenant complied with the MIA requirement. However, this was not the case for the Terminal 2 submittals. As a result, RDM has been faced with a review of tenants' MIA documents that is more challenging and time-consuming than necessary. RDM agrees, as two of its property managers noted, that tenants' MIA submittals could be better organized.

## Recommendations

The Airport should:

3. Require the 12 tenants that submitted inadequate minimum investment amount supporting documents to submit adequate supporting documents that clearly and directly substantiate the construction costs listed on the tenants' affidavits.
4. Develop and implement instructions that require all tenants to submit minimum investment amount supporting documents that include paid invoices or lien waivers, as required by lease agreements.

5. Develop and implement instructions that require all tenants to submit minimum investment amount supporting documents that directly and clearly support the reported total construction costs.
6. Develop and implement instructions that require all tenants to submit minimum investment amount supporting documents that contain appropriate and allowable costs.
7. Develop and implement instructions that require all tenants to submit minimum investment amount supporting documents that are well-organized to enable quick and easy review by the Airport.

### Finding 1.3

#### **RDM does not validate MIA documentation for accuracy and completeness.**

*RDM staff do not validate MIA documentation.*

RDM staff does not review the supporting documentation submitted by the tenants to validate that it accurately and completely corresponds to the reported construction costs. Instead, RDM staff only enters the certified construction costs reported by the tenants into a shared central log sheet and conduct a high-level check of the reported construction costs against the MIA. Without validating the accuracy and completeness of MIA supporting documentation, the Airport has limited assurance that tenants have, in fact, met the Airport's standards for refurbishing, redecorating, and modernizing Airport premises, as required in the tenant lease agreements.

*Collecting MIA documents is important for a variety of reasons.*

According to RDM's employee handbook, the collection of certified construction costs, which are the basis for determining tenants' compliance with MIA requirements, are needed to:

- Ensure that the MIA was met.
- Provide general data that RDM could share with prospective tenants to enable them to better evaluate the business opportunity.
- Provide the basis for a potential buy-out before lease expiration.

Validating the accuracy of certified construction costs and reviewing supporting documents would ensure that the

costs included in the supporting documents add up to the construction costs reportedly paid by the tenants. Research of industry best practices (for example, from the U.S. Department of Transportation, Federal Aviation Administration) and other jurisdictions (for example, Mineta San Jose International Airport and Los Angeles World Airports) shows that supporting documentation from tenants should be required for any terminal construction project close-out and that the owner, in this case RDM, should review those documents closely to validate costs.

**Recommendation**

8. The Airport should develop and implement policies and procedures for regularly reviewing the minimum investment amount supporting documentation submitted by tenants to validate that the documentation accurately and completely corresponds to reported construction costs.

**Finding 1.4**

*Due date requirement was inconsistent among the leases.*

**RDM's procedures do not ensure timely submittal of MIA documentation.**

RDM has no policy or procedures regarding setting consistent MIA supporting documentation due dates. As a result, Terminal 2 concession leases contain varying deadlines for submitting MIA documentation. For example, of the 16 leases:

- 13 required submittal of MIA documentation within 90 days after substantial completion.
- 2 required submittal within 30 days.
- 1 required submittal within 60 days.

Consistent due dates for tenant submittals make for easier communication with tenants and uniform close-out procedures among property managers. Inconsistent due dates not only make tracking more difficult, but could result in confusion among tenants, as well as the appearance of unfairness when some tenants are held to deadlines that are more or less generous than others.

Other jurisdictions contacted for this audit consistently applied the same due dates among their tenants, which varied from 60 days after construction completion (Los Angeles World Airports) to 120 days after substantial completion (Oakland International Airport).

*RDM does not track the timeliness of MIA documentation.*

RDM does not actively track whether tenants submit supporting documents on time. As a result, the vast majority of tenants (15 of 16) submitted their MIA documentation late, ranging from 7 to 71 days (or over 2 months) late, with an average submittal date of 40 days after the due date called for by the lease. Besides not complying with the lease, late MIA documentation submittals limit RDM's capacity to review and follow up on the accuracy and completeness of MIA documentation in a timely manner.

**Recommendations**

The Airport should:

9. Develop and implement policy and procedures on setting consistent due dates for tenants to submit minimum investment amount supporting documentation.
  
10. Actively track the timeliness of tenants' minimum investment amount documentation submittals to ensure that its staff reviews and follows up on the accuracy and completeness of minimum investment amount documentation in a timely manner.

**Finding 1.5**

**RDM's calculation basis for the MIA does not vary by concession type.**

*The "one-size-fits-all" basis of the Terminal 2 MIA is not optimal.*

RDM set the MIA at \$350 per square foot regardless of the type of concession or size of the space leased. This "one-size-fits-all" calculation basis differs from those of the three other jurisdictions contacted for the audit, all of which use MIA bases that vary by type of concession. Also, one of the jurisdictions uses a higher MIA per square foot for smaller spaces. As for the amount of the MIA, on average RDM uses a lower basis per square foot for food and beverage concessions and the same basis for retail concessions in Terminal 2 as compared to those of the other jurisdictions, as shown in Exhibit 6.



**EXHIBIT 6 Minimum Investment Amount Bases Used by Selected Jurisdictions**

Jurisdiction	Food & Beverage MIA per Square Foot	Retail MIA per Square Foot
Oakland International Airport	\$400-450 <sup>a</sup>	\$325 <sup>a</sup>
Mineta San Jose International Airport	\$350 <sup>a</sup>	\$275 <sup>a</sup>
Los Angeles World Airports	\$650	< 900 square feet: \$550 >900 square feet: \$450
Average	\$467 <sup>b</sup>	\$350 <sup>b</sup>
<i>San Francisco International Airport</i>	\$350	\$350

Notes:

<sup>a</sup> According to jurisdiction's latest request for proposal

<sup>b</sup> Derived using the lower-bound amount for jurisdictions with ranges (i.e., Oakland's food and beverage MIA, and Los Angeles' retail MIA)

Source: Auditor's survey of other jurisdictions.

*Stores recently built-out at the Airport averaged \$450 per square foot.*

According to one jurisdiction's representative, varying the MIA basis by concession type makes sense because spaces for food and beverage concessions are typically more expensive to build-out than those for non-food businesses due to the high cost of equipment. Although RDM set the MIA for Terminal 2 leases at \$350 per square foot, RDM's employee handbook developed in 2010 states that the construction cost for recently built-out stores at San Francisco International Airport has averaged \$450 per square foot over the last few years. This may indicate the need to revise the current MIA basis of \$350 per square foot to reflect actual trends in construction costs.

**Recommendations**

The Airport should:

11. Develop minimum investment amount calculation bases that vary by concession types.
12. Revise its minimum investment amount basis of \$350 per square foot for food and beverage and retail concessions to reflect trends in construction costs and practices of comparable jurisdictions.

**Finding 1.6**

**MIA waivers potentially weaken the purpose of the MIA requirements.**

*Leases contain a waiver clause for the MIA requirements.*

While the leases require tenants to meet the MIA requirement of \$350 per square foot, some of the leases contain a clause indicating that the Airport director may waive or reduce the requirement provided the tenant (1)

complies with the Terminal 2 Concessions Design Guidelines and (2) has completed its work as approved by the Design Review Committee. According to RDM staff, tenants must go through the Design Review Committee and receive approvals for plans before starting construction. Therefore, if the tenant meets the two conditions, the Airport director may waive or reduce the MIA requirement. Allowing the Airport director to grant tenants an MIA waiver potentially weakens the purpose of the MIA, which is to ensure that Airport premises are built-out to an acceptable level of quality.

**Recommendation**

13. The Airport should determine whether the minimum investment amount waiver weakens the purpose of the minimum investment amount requirement. If the waiver is determined to be counterproductive, omit the waiver provision from future agreements.

## CHAPTER 2 – Airport Procedures for Tracking Tenants' As-Built Drawings Need Improvements

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### Summary

The Airport's procedures for collecting and tracking as-built drawings do not adequately ensure tenant compliance. Over half of the 21 businesses at Terminal 2 have not complied with the as-built drawing requirements, and most of the businesses submitted as-built drawings an average of almost three months late. This lack of compliance with the as-built requirements is attributable to the leases not explicitly requiring as-built drawings submittal and not including penalties for non-compliance. In addition, RDM has no formal procedures for collecting and tracking as-built drawings, and the Airport issues conflicting instructions on the entity responsible for tracking as-built drawings compliance. RDM should develop and implement clear and consistent procedures for the various facets of as-built drawings compliance monitoring to ensure that tenants adhere to all relevant requirements and, more importantly, that the Airport has adequate information to appropriately base its tenant buy-out decisions in the future.

### Finding 2.1

**Half of the 21 businesses have not complied with some as-built drawing requirements.**

*Half of the 21 businesses have not complied with as-built drawing requirements.*

Of the 21 businesses at Terminal 2, 11 (52 percent) have either been found by the Airport to be noncompliant based on the as-built drawings submitted (9 businesses<sup>4</sup>), or had not submitted their as-built drawings as of February 2012 and were past due (2 businesses<sup>5</sup>). Five businesses were found to be compliant with the as-built drawing requirements,<sup>6</sup> and the remaining 5 have submitted as-built drawings that have not yet been reviewed by the Airport for compliance.<sup>7</sup> Exhibit 7 summarizes the status of the 21 Terminal 2 businesses' compliance with the as-built drawing requirements.

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<sup>4</sup> These are Andale Management's Andale; D-Lew Enterprises' Lark Creek Grill, Napa Farms Market, and Vino Volo; Books Inc.'s Compass Books; XpresSpa; Gotham Enterprises' Peet's Coffee and Tea; Sankaku's Wakaba Sushi & Noodle; and Melshire's Natalie's Candy Jar. These business submitted drawings that were either not as-built drawings or were not in the required format.

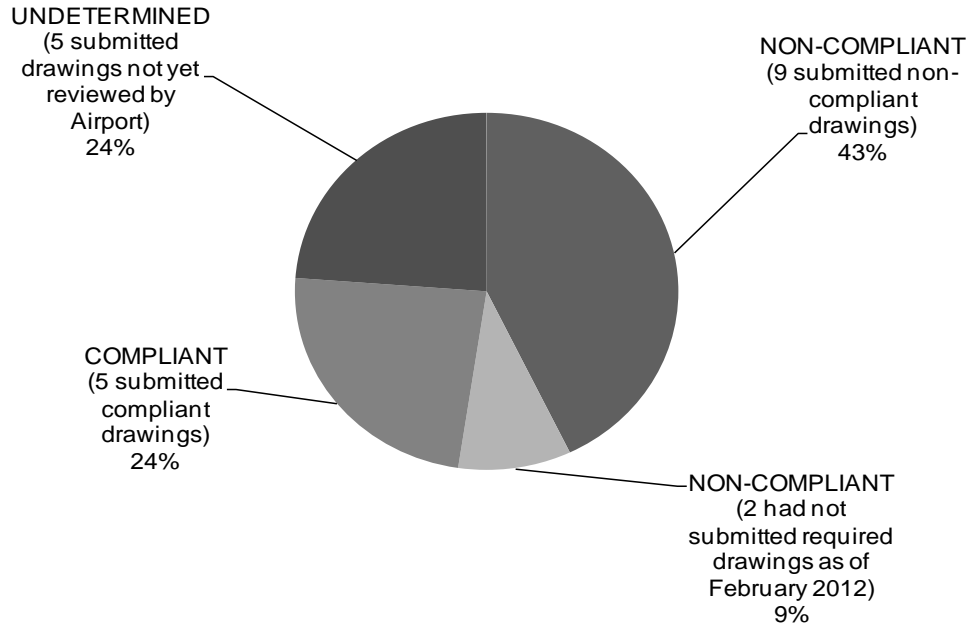
<sup>5</sup> These are Edge 1 Cellular's I-Tech X-perience and RDG Concessions' Pacific Outfitters.

<sup>6</sup> These are Host International's Starbuck's, Kiehl's, Mango, SFO News Express, and Sunset News.

<sup>7</sup> These are BJ Annex's Burger Joint, HBF Soto's Cat Cora and The Plant Café Organic & Pinkberry, Avila Retail Development's Greetings from San Francisco and Mosaic Fine Art and Craft Gallery.

**EXHIBIT 7**

**Compliance of Terminal 2 Businesses With As-Built Drawing Requirements**



Source: Auditor's analysis of Airport information.

*Most of the businesses submitted as-built drawings an average of almost three months after the 30-day deadline.*

Of the 19 businesses in Terminal 2 for which drawings have been submitted, 18 (95 percent) submitted as-built drawings an average of almost three months after the deadline. Only 1 business (Sunset News operated by Host International, Inc.) submitted drawings within 30 days of construction completion, as required by the Tenant Improvement Guide. Drawings were submitted 50 to 190 days after work completion, or 20 to 160 days late. An average of 112 days elapsed from the completion of the tenant's work to the day as-built drawings were submitted, which was 82 days, or almost three months, beyond the 30-day deadline.

Given that almost all Terminal 2 businesses submitted their as-built drawings late, the 30-day deadline may not be feasible (or necessary) in many cases. Of the three other jurisdictions contacted for the audit, one has a 30-day deadline for as-built drawings, while the other two allow 60 or 90 days following construction completion.

*As-built drawings are a valuable tool for the Airport.*

As-built drawings show the final design and specifications used to complete a project. Because contractors may not follow originally approved drawings in every respect, as-

built drawings are an official record of the project at the completion of construction. Being able to see exactly what was constructed, some of which is hidden when the work is finished, will be important to the Airport if it decides to buy out the tenant's space and may be useful to the next tenant. For these reasons, collecting and maintaining complete and accurate as-built drawings is important for the project's operation and maintenance, and for all future modifications, particularly with respect to plumbing and electrical systems.

## Recommendations

The Airport should:

14. Require the 11 non-compliant businesses to submit as-built drawings in the correct format.
15. Ensure that all as-built drawings submitted by tenants are promptly reviewed by Airport staff to determine compliance.
16. Develop and implement procedures to require all businesses to submit as-built drawings on time, as required by the leases.
17. Determine whether the 30-day deadline for as-built drawing submittal should be extended.

## Finding 2.2

*Leases do not explicitly require the submittal of as-built drawings, nor do they include penalties for non-compliance.*

### **RDM's policies and procedures do not ensure tenant compliance with as-built drawing requirements.**

RDM's policies and procedures for collecting and tracking as-built drawings do not ensure tenant compliance with the requirements. For example, despite the importance of as-built drawings, they are not explicitly required by the Terminal 2 leases. In addition, there is no penalty for not submitting as-built drawings. The one lease provision that indirectly relates to as-built drawings is a general clause requiring tenants to comply with all laws, rules, and regulations, including those referred to in the Tenant Improvement Guide. This guide covers, among other things, the as-built drawings requirement, stating that the tenant shall furnish the Airport with a complete set of as-built drawings that are submitted:

- With signatures and dates on reproducible tracings.
- In the latest version of AutoCAD and/or Softdesk for electronic files.

- Within 30 days of construction completion.

*RDM lacks procedures to properly track as-built drawings compliance.*

Further, RDM has no formal procedures for collecting and tracking as-built drawings. For example, except for a brief description of the Building Inspection and Code Enforcement unit (BICE) being responsible for reviewing and approving all tenant improvement construction drawings, RDM's employee handbook does not state how as-built drawings compliance should be monitored.

*Clear policies and procedures are needed to ensure tenant compliance.*

RDM risks having inadequate and incomplete as-built drawings of Airport premises if leases do not explicitly require as-built drawings and provide detail about what is required. In addition, with no penalty for tenants that fail to submit the drawings or submit them late, it is difficult for RDM to enforce these requirements. Further, having formal procedures for collecting and tracking as-built drawings would help ensure that the Airport has adequate and complete build-out information it needs when it needs it.

## Recommendations

The Airport should:

18. Explicitly include the as-built drawing requirements in future concession tenant leases. Leases should specify the correct format and deadline for as-built drawings, and a penalty for not submitting them as required.
19. Develop and implement clear policies and procedures for collecting and tracking as-built drawings.

## Finding 2.3

### **The Airport has not clearly identified the entity responsible for tracking as-built drawings compliance.**

*The Airport issues conflicting instructions on the entity responsible for tracking as-built drawings compliance.*

The Airport has not clearly identified the entity responsible for monitoring the tenants' as-built drawings compliance. For example, the letters the Airport sends to tenants regarding as-built drawings are both duplicative and inconsistent. Both BICE and RDM send letters to tenants reminding them of as-built drawing submittals, but BICE's letter instructs tenants to submit the drawings to RDM, while RDM's letter instructs tenants to submit the drawings to BICE. Moreover, no one at the Airport follows up with tenants if they are late in submitting as-built drawings or they submitted incorrect drawings.

The Airport's duplicative efforts and conflicting instructions

have resulted in the lack of a single comprehensive and up-to-date list of all as-built drawing submittals. To create a complete list of as-built drawing submittals and compliance status, the audit team combined information from two sources: RDM and the Airport's Business and Finance Division.

Research on close-out best practices shows that responsibilities for staff involved in close-out procedures should include:

- Gathering as-built drawings
- Ensuring that as-built drawings are complete
- Maintaining a master file of as-built drawings

At project close-out, the owner (the Airport in this case) is to confirm the build-out completion and that the tenant's submittal of all required information, including as-built drawings, meets requirements. The owner should also document its acceptance of the tenant's submittal. Clearly and consistently defining who is responsible for the various facets of tracking as-built compliance is important to ensure that tenants adhere to all relevant requirements and that the Airport maintains adequate information on which it may need to base its tenant buy-out decisions in the future.

## Recommendations

The Airport should:

20. Collaborate with the Airport's Building Inspection and Code Enforcement unit and Business and Finance Division to develop and implement clear and consistent roles and responsibilities for monitoring tenants' as-built drawings compliance.
21. Maintain complete and up-to-date logs of all tenants' as-built drawing submittals and compliance status.

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## APPENDIX: DEPARTMENT RESPONSE

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San Francisco International Airport

May 9, 2012

Tonia Lediju  
Audit Director  
Office of Controller, City Services Auditor Division  
City and County of San Francisco  
City Hall, Room 476  
1 Dr. Carlton B. Goodlett Place  
San Francisco, CA 94102

In re: Responses to Findings from the San Francisco International Airport –  
T2 Construction Close-out Cost Audit

Dear Ms. Lediju:

We have received and reviewed the draft report regarding T2 Construction Close-out Cost Audit. We appreciate the time and effort of your staff in conducting this audit. Enclosed for your review are Revenue Development and Management's responses to the Office of the Controller's audit.

If you have any questions or require further information, please contact me at 650.821.4501.

Very truly yours,

A handwritten signature in black ink, appearing to read "Cheryl Nashir", with a stylized flourish at the end.

Cheryl Nashir  
Associate Deputy Airport Director  
Revenue Development and Management

AIRPORT COMMISSION CITY AND COUNTY OF SAN FRANCISCO

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## AUDIT RECOMMENDATIONS AND RESPONSES

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Recommendation	Responsible Agency	Response
<p>The Airport should:</p> <p>1. Collect the deficiencies totaling \$227,269 from Books, Inc., (\$186,365) and Edge 1 Cellular, L.P., (\$40,904) for not meeting the minimum investment amount requirement in their lease agreements.</p>	Airport	Do not concur. The Airport will not collect these deficiencies, rather it will rely upon the language in the Lease Summary which specifies the Minimum Investment Amount is \$350 per square foot or whatever is necessary to satisfy the Terminal 2 Design Guidelines and Design Review Committee's (DRC) requirements. Both build-outs complied with the design guidelines and are satisfactory to the DRC. The Airport is using the Terminal 2 tenant quality of build-out and design aesthetic as the new standard for all future development.
<p>2. Use consistent language in the bodies and summaries of tenant lease agreements to ensure clarity and consistency in the application of lease provisions.</p>	Airport	Concur. Revenue Development and Management (RDM) staff has updated both its Retail and Food and Beverage Lease Boilerplates to include identical waiver language in the Lease Summary and the body of the Lease. Also, the Airport has updated both Boilerplate Leases to have consistent due date language.
<p>3. Require the 12 tenants that submitted inadequate minimum investment amount supporting documents to submit adequate supporting documents that clearly and directly substantiate the construction costs listed on the tenants' affidavits.</p>	Airport	Concur. The Airport will pursue this and update the Controller's Office in a follow-up report to this audit.

Recommendation	Responsible Agency	Response
4. Develop and implement instructions that require all tenants to submit minimum investment amount supporting documents that include paid invoices or lien waivers, as required by lease agreements.	Airport	Concur. RDM staff currently provides the tenants with an Affidavit of Tenant Improvement Work form to fill out, general instructions and due date reminders. RDM staff will bolster this process by 1) discussing the construction close-out process with the tenant, in detail, early in the design and construction process; 2) creating and showing tenants a sample "certified costs package" during this discussion; 3) specify the need for all costs to be reconciled and justified clearly and concisely; 4) not accepting incomplete packages; and, 5) issuing fines if necessary for compliance.
5. Develop and implement instructions that require all tenants to submit minimum investment amount supporting documents that directly and clearly support the reported total construction costs.	Airport	Concur. See answer #4 above.
6. Develop and implement instructions that require all tenants to submit minimum investment amount supporting documents that contain appropriate and allowable costs.	Airport	Concur. See answer #4 above.
7. Develop and implement instructions that require all tenants to submit minimum investment amount supporting documents that are well-organized to enable quick and easy review by the Airport.	Airport	Concur. See answer #4 above.

Recommendation	Responsible Agency	Response
8. Develop and implement policies and procedures for regularly reviewing the minimum investment amount supporting documentation submitted by tenants to validate that the documentation accurately and completely corresponds to reported construction costs.	Airport	Concur. RDM staff will participate in a workshop at its June staff meeting regarding tenant education of the administrative construction close-out process; the collection and analysis of costs; and, the collection and processing of as-built drawings.
9. Develop and implement policy and procedures on setting consistent due dates for tenants to submit minimum investment amount supporting documentation.	Airport	Concur. RDM staff has updated both its Retail and its Food and Beverage Lease Boilerplates to allow tenants 90 days to submit as-builts and certified costs.
10. Actively track the timeliness of tenants' minimum investment amount documentation submittals to ensure that its staff reviews and follows up on the accuracy and completeness of minimum investment amount documentation in a timely manner.	Airport	Concur. These dates and requirements are already tracked on a master Design and Construction schedule, utilizing Excel. Airport staff will formally add the review of close-out submittal dates to its monthly report review.
11. Develop minimum investment amount calculation bases that vary by concession types.	Airport	Concur. See answer #12 below.

Recommendation	Responsible Agency	Response
12. Revise its minimum investment amount basis of \$350 per square foot for food and beverage and retail concessions to reflect trends in construction costs and practices of comparable jurisdictions.	Airport	<p>Concur. The Airport will raise the minimum investment requirement for retail from \$350 to \$400. This is more reflective of construction in the last 3 years. The average cost per square foot for all Terminal 2 retail was \$421.</p> <p>The Airport will raise the minimum investment requirement for food and beverage from \$350 to \$500 per square foot for full service restaurant and other large footprint food and beverage locations. The Airport will raise the minimum investment requirement for food and beverage from \$350 to \$750 per square foot for quick serve and kiosk locations. These new amounts more accurately reflect costs incurred in the Terminal 2 project and two other food/beverage facilities built since 2008.</p>
13. Determine whether the minimum investment amount waiver weakens the purpose of the minimum investment amount requirement. If the waiver is determined to be counterproductive, omit the waiver provision from future agreements.	Airport	<p>Concur. The Airport will maintain the waiver as it affords a reasonable way to deal with construction savings that may be realized during different economic times; may keep small and/or local businesses, that could have less sophisticated designs and finishes, interested in doing business at the Airport; and, is not detrimental as it affords the Airport Director (aided by the Airport's Design Review Committee) discretion regarding the waiver.</p>
14. Require the 11 non-compliant businesses to submit as-built drawings in the correct format.	Airport	<p>Concur. The Airport will pursue this and update the Controller's Office in a follow-up report to this audit.</p>
15. Ensure that all as-built drawings submitted by tenants are promptly reviewed by Airport staff to determine compliance.	Airport	<p>Concur. See answer #20 below.</p>

Recommendation	Responsible Agency	Response
16. Develop and implement procedures to require all businesses to submit as-built drawings on time, as required by the leases.	Airport	Concur. See answer #10 above.
17. Determine whether the 30-day deadline for as-built drawing submittal should be extended.	Airport	Concur. RDM staff has clarified in the Boilerplate Leases the period within which close-out documentation is required as within 90 days of construction completion. This allows a reasonable amount of time for punch list work which could result in changes to the as-built drawings and certified costs.
18. Explicitly include the as-built drawing requirements in future concession tenant leases. Leases should specify the correct format and deadline for as-built drawings, and a penalty for not submitting them as required.	Airport	Concur. RDM staff has clarified in the Boilerplate Leases the drawing submittal requirements.
19. Develop and implement clear policies and procedures for collecting and tracking as-built drawings.	Airport	Concur. RDM staff will formally add the review of close-out submittal dates to its monthly report review. These dates and requirements are already tracked on a master Design and Construction schedule, utilizing Excel.
20. Collaborate with the Airport's Building Inspection and Code Enforcement unit and Business and Finance Division to develop and implement clear and consistent roles and responsibilities for monitoring tenants' as-built drawings compliance.	Airport	Concur. RDM staff is working with the Business and Finance staff architect and the Bureau of Design and Construction head architect to develop the appropriate library of tenant as-built drawings, including the acceptance, review, filing and cataloguing of these electronic and/or paper drawings. The Airport will inform the Controller's Office of the details of this new process in a follow-up report to this audit.

<b>Recommendation</b>	<b>Responsible Agency</b>	<b>Response</b>
21. Maintain complete and up-to-date logs of all tenants' as-built drawing submittals and compliance status.	Airport	Concur. See answer #20 above.