United States General Accounting Office

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Report to the Honorable
Hank Brown, U.S. Senate

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DENVER AIRPORT

Operating Results and Financial Risks

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GAO

United States
General Accounting Office
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Accounting and Information Management Division

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February 9, 1996

The Honorable Hank Brown
United States Senate

Dear Senator Brown:

You asked us to consult with you on the financial viability of the Denver International Airport (DIA), which opened for operations on February 28, 1995. Specifically, you asked that we (1) analyze the limited data available on actual results after DIA opened for operations and (2) identify the risks associated with assessing DIA's financial condition. You also asked us to review estimated cash flows and DIA's cash reserves. Finally, you asked us to comment on DIA's ability to meet its financial obligations, including payments to its bondholders.

Results in Brief

In any attempt to estimate future financial performance, differences between expected and actual results of operations may arise because events and circumstances frequently do not occur as expected, and those differences may be material. Furthermore, current operating results are not necessarily predictive of future results and can only provide an indication of an entity's future performance. This is especially true in the early stages of new commercial operations. At the time of our review, DIA had only been operating for 6 months, and, accordingly, the actual financial data available on operations were of limited predictive value.

In addition to the inherent risks that are always present when making financial projections, there are a number of risks that are specific to DIA's operations. For example, DIA's future financial performance could be threatened if (1) United Airlines, its major tenant, or the airline industry in general underwent financial stress or upheaval, (2) DIA experienced significant declines in passenger volumes, or (3) unknown construction defects resulted in major unexpected costs.

Further, the City of Denver has acknowledged that the Securities and Exchange Commission (SEC) is conducting a formal investigation regarding the adequacy of the city's disclosure of information in bond offering documents with respect to the automated baggage system and related delays in opening the airport. Current estimates of whether the city will be able to repay investors would not appear to be within the scope of the SEC's investigation. Generally, when the SEC finds a violation of federal securities law, it can pursue various enforcement mechanisms, including a "cease-and-desist" order, or it can ask a court to impose monetary penalties. In addition, DIA bondholders have filed several class action lawsuits seeking damages related to inadequate disclosures. Any SEC determination that disclosures were not fair or complete could affect the results of these lawsuits.

Based on our review of the data available as described in this report, we found no issues that would lead us to believe that DIA would be unable to meet its financial obligations, including payments to bondholders under current financing arrangements. However, the risk factors we identified could result in limiting DIA's future ability to meet its obligations. We emphasize that these risk factors should be carefully considered by users of our report.

Background

DIA was built to replace Stapleton International Airport (SIA), which in 1994 was the eighth busiest airport in the world. A great deal of controversy was generated by DIA's construction. Proponents pointed to various inadequacies related to SIA's facilities, limits on expansion, and noise pollution. Opponents raised objections related to DIA's construction and operating costs, levels of future passenger demand, and long-term financial viability. The airport, which opened for business on February 28, 1995, experienced numerous construction delays and cost overruns. Allegations of inadequate disclosures in bond offerings to the public have resulted in an SEC investigation and several lawsuits.

About 65 percent of DIA's revenues are collected from the airlines for space rental and landing fees. The remaining 35 percent of revenues come from concessions, passenger facility charges (PFCs),[1] interest income, and other sources.

To help ensure that revenues will cover costs, DIA has a rate maintenance covenant with bondholders. This covenant requires DIA to set annual rates and fees to result in an amount that, when combined with funds held in reserve in the coverage account,[2] is equal to (1) all costs of operating the airport plus (2) 125 percent of the debt service requirements on senior

[1]The Aviation Safety and Capacity Expansion Act of 1990 authorizes a locally imposed PFC of up to $3 per enplaned passenger. In May 1992, the Federal Aviation Administration approved Denver's PFC application, authorizing the city to collect up to $2.3 billion in PFC revenues through the year 2025.

[2]The coverage account is a cash account required to be maintained at a specific level by DIA's bond indentures. As of September 25, 1995, this account had $47 million. By December 31, 1996, it is required to have $58.4 million.

bonds for that year. Senior bonds comprise about $3.5 billion of DIA's total $3.8 billion bond debt. DIA's revenue bonds were issued under the 1984 General Bond Ordinance, which promises bondholders that the rate maintenance covenant will be honored in setting billing rates for airlines.

Under the airlines' use and lease agreements, each airline is required to pay rates and charges sufficient to meet the rate maintenance covenant after taking into consideration all airport revenues. Because there are no limits on costs built into the rate maintenance cost recovery model, DIA has agreed to share 80 percent of net receipts[3] with airlines for 5 years from February 28, 1995, and lower percentages thereafter. After sharing net receipts with the airlines, DIA estimates that it will retain an estimated $6.3 million to $7.6 million a year for fiscal years 1996 through 2000, which will be transferred into the capital fund.

Many airports calculate the airlines' cost per enplaned passenger as a benchmark. This cost is based on the airlines' share of airport costs, divided by the actual number of enplaned passengers. DIA's lease contract with United Airlines includes a provision for nullifying the contract if the cost per enplaned passenger rises beyond a predetermined level.

Scope and Methodology

To identify risks that could affect DIA's financial performance, we read and evaluated risk disclosures in DIA's Official Statements; interviewed DIA, Colorado Springs Airport, and SEC officials; obtained financial information on United Airlines; interviewed airline industry experts, including airline executives, aviation forecasters, and airline financial consultants; and obtained data from American Express on ticket prices at DIA.

To review DIA's revenues, we (1) sampled DIA's daily revenue transactions for March through May 1995 and examined supporting documentation regarding collections of airline rents and landing fees, (2) tested supporting documentation for revenues from concessions such as parking, fees from rental car companies, food and beverage concessions, and retailers, (3) extracted data from reports on City of Denver investment income and journal vouchers on receipts of passenger facility charges from airlines, (4) compared actual revenues for March through May 1995 to the monthly estimates of cash flows DIA prepared for 1995, (5) analyzed and studied for consistency DIA's long-term estimates covering 1996 through 2000 for revenue and other financial information, and (6) reviewed the terms of lease agreements with airlines and cargo

[3]Net receipts represent total receipts less total disbursements before allocations to airlines.

carriers, obtained and analyzed passenger data from airline landing reports for March through August 1995, and became familiar with the rates and charges methodology DIA used to set rental rates and landing fees for airlines.

To review DIA's debt service requirements, we examined DIA's plan of finance, which summarized details on all outstanding revenue bonds at DIA and contained detailed amortization schedules for paying off revenue bonds. We compared selected payments on this schedule to bond documents. We also inspected documentation for actual transfers of operating funds to DIA's bond fund for March through May 1995.

To review DIA's operating costs, we obtained DIA's weekly cash flow statements for March through May 1995 and operating expense data files for that period and traced samples from those files to supporting documentation. We also reviewed DIA's operations and maintenance cost budgets by studying supporting documentation, such as contracts and other DIA budgetary analysis, for all budgetary line items exceeding $1 million. We compared DIA's budgets to those of other operating airports. Finally, we interviewed DIA and City of Denver officials to gain an understanding of the accounting system for DIA expenses and to obtain further information about transactions tested.

We used information from our tests of revenues, bond debt, and expenses to prepare a statement of actual cash flows for March through May 1995. We also analyzed the cash balances the City of Denver maintained in DIA operating and cash reserve accounts.

To review DIA's actual cash reserves and cash flows, we obtained cash reserve balances from City of Denver accounting records and reviewed the audit work papers of DIA's auditors, identified restrictions on the use of reserve funds, interviewed bond analysts, and performed detailed analyses of DIA documentation supporting cash receipts and disbursements.

We also interviewed DIA managers and airline officials and reviewed testimony before a congressional subcommittee by proponents and opponents of DIA.

We performed our work between March 1995 and November 1995 in accordance with generally accepted government auditing standards for performance audits. This report is not intended to be a financial projection under the American Institute of Certified Public Accountants' standards for such reporting.

Risks That Could Affect DIA's Future Financial Condition

There are certain risks inherent in any projection of financial data to future periods. Specifically, differences between expected and actual results of operations may arise because events and circumstances frequently do not occur as expected, and those differences may be material.

In addition, DIA's future financial performance could be threatened by a number of factors specific to the airport's operations, most notably the overall volatility of the airline industry in general and any future deterioration in the financial health of its major tenant, United Airlines. Also, because DIA's revenues are primarily driven by passenger volume, increased ticket prices may be a concern if they result in significant passenger declines. Other risks include the possibility of (1) unknown construction defects resulting in major unexpected costs or (2) adverse actions arising from a current Securities and Exchange Commission investigation and/or lawsuits filed by bondholders against DIA. The potential severity of the effect on DIA's future financial condition varies with each of these risk elements.

Health of the Airline Industry and United Airlines

Financial results of the airline industry, a key risk factor, have been volatile since deregulation in 1978. Most airlines have reported substantial net losses since 1990, with total losses of about $13 billion from 1990 through 1994. For example, one of the airlines that used DIA, MarkAir, filed for bankruptcy in April 1995 and went out of business in October 1995.

In addition to the condition of the airline industry in general, an important factor affecting DIA's financial viability is the financial health of its major tenant, United Airlines. United accounted for over 70 percent of passenger enplanements during the first 4 months of 1995, as discussed later. Also, DIA has projected that 43.1 percent of enplanements for 1995 will be passenger transfers as a result of United's hubbing operation.

United Airlines reported annual losses in 1993, 1992, and 1991 of $50 million, $957 million, and $332 million, respectively. United reported profits in 1994 for the first time since 1990, with net earnings of $51 million shown on its audited financial statements for the calendar year 1994. United Airlines is thinly capitalized, with net equity of about $76 million and debt of about $12 billion, reported as of March 31, 1995. In late October 1995, United announced record profits of $243 million for the quarter ended September 30, 1995.

In commenting on a draft of this report, DIA's Director of Aviation acknowledged that there are risks inherent with any business venture and related financial projections and that the volatility of the airline industry could impact the financial performance of DIA. The comments point out DIA's view that the risks associated with the financial health of United Airlines are offset by several factors, including DIA's strong market in both origination and destination travel as well as regional connecting traffic.

Risks to Passenger Volume

Risks to passenger volume is another key consideration in DIA's future financial health. One factor influencing passenger volume, in turn, is ticket prices. Ticket prices at DIA increased 20 percent to 38 percent compared to those charged a year earlier at SIA. American Express recently reported that the average fare paid at DIA for March 1995 was 20 percent higher than fares at SIA in March 1994, with an average fare of $290 at DIA compared to $241 at SIA.[4] American Express also reported that the average fare nationally, based on 215 domestic city pairs, showed no change during that period. In addition, the American Express review for the second quarter of 1995 reported that the average fare paid at DIA in June 1995 was 38 percent higher than the average fare at SIA in June 1994, while the average fare was up 7 percent nationally during that period.

We also reviewed the Department of Transportation's (DOT) airfare statistics, which are based on a broader 10 percent sample of all domestic airline travel. DOT's data showed that the average fare for Denver travel for the second quarter of 1995—DIA's first full quarter of operation—was 9 percent higher than the SIA fare for the same period in 1994. According to DOT's statistics, the average fare nationwide for the second quarter of 1995 was 2.4 percent higher compared to the average fare 1 year earlier.

According to airline industry representatives we interviewed, airport charges to airlines for rental costs and landing fees represent a small fraction of airlines' total costs, which also include, for example, aircraft

[4]The American Express Business Travel Review, 1st Quarter, 1995, pp. 14-15. American Express's computation was based on a one-way average price paid by all business travelers booked by American Express Business Travel who traveled from DIA to 10 other cities. The 10 cities were selected based on a large number of yearly passengers or those that provide widespread geographic balance. The ten cities paired with DIA were Atlanta, Chicago, Dallas, Newark, Omaha, Salt Lake City, San Francisco, San Jose, Seattle, and Washington, D.C.

fuel and maintenance costs and personnel and benefits expenses. Thus, the industry officials indicated that the lack of a competitive market in the Denver area for United Airlines, rather than DIA airline charges, is probably the most important factor affecting the price of tickets. United Airlines dominates the market at DIA, carrying about 70 percent of all passengers enplaned in Denver during the first 4 months of 1995. Historically, Continental Airlines was United's major competition in the Denver market; however, as discussed later, Continental has eliminated its hubbing operation from Denver.

Airlines that have a reputation for low fares, such as Southwest, have stated in media reports that they have chosen not to use DIA because its rates are too high. The airport at Colorado Springs, which is located about 70 miles south of Denver, has attracted a low fare airline, Western Pacific Airlines, that is offering competition to DIA. Colorado Springs expects to enplane 1.4 million passengers in 1995 compared to 791,000 in 1994, a 72-percent growth rate. Colorado Springs Airport officials told us that some of the growth is fueled by Denver passengers, although they have not performed any studies to verify this. Future growth at Colorado Springs, however, will be limited by its size; it is currently operating at full capacity with only about 7 percent of DIA's passenger volume.

Our analysis of landing reports generated by the airlines for the first 6 months of operations at DIA showed that DIA enplaned 100.3 percent of forecasted passengers for March, April, and May 1995. However, volumes declined through the summer of 1995 as compared to forecasts, with 94.5 percent in June, 90.6 percent in July, and 89.0 percent in August.[5] DIA officials stated that higher ticket prices were the primary cause of the decline in passenger volume in the summer of 1995, as well as the loss of Continental's hubbing operation. Passenger volume has improved in recent months, with 90.3 percent of forecasted passengers enplaned in September, 94.8 percent in October, and 99.1 percent in November.

Risk of Construction Defects

Another critical risk factor that we identified are the many allegations that have been made about improper construction practices at DIA, involving the main terminal, concourses, and runways. Although investigations to date have not disclosed major deficiencies that would result in significant repair costs, if undisclosed defects are present that eventually cause expensive repairs, DIA's cost structure could be materially affected. It

[5]Our analysis included an adjustment for seasonality in passenger demand by considering that historical data for March through August for the years 1992 through 1994 at SIA show that 53.66 percent of annual Denver passengers were enplaned in this 6-month period.

should be noted, however, that the City of Denver's contracts with its DIA building contractors included a standard "Latent Defect Clause." This clause states that any hidden defects that develop as a result of materials and equipment incorporated into the project will be remedied by the contractor at no extra cost to the city.

Potential Adverse Actions Resulting From SEC Investigation and Bondholder Lawsuits

The City of Denver has advised us that the Securities and Exchange Commission (SEC) is conducting a formal investigation regarding the adequacy of the city's disclosure of information in bond offering documents with respect to the automated baggage system and related delays in opening the airport. Current estimates of whether the city will be able to repay investors would not appear to be within the scope of that investigation. Generally, when the SEC finds a violation of federal security law, it has the discretion to pursue a range of enforcement mechanisms and penalties. The SEC may, for example, require correction of public filings, direct future compliance, or, in some circumstances, ask a court to impose monetary penalties.

The City of Denver provided us with a copy of a letter dated October 11, 1995, in which SEC regional staff advised the city that as a result of its investigation, the staff planned to recommend that the Commission institute an administrative action, the next step in the SEC's enforcement process. The city was given an opportunity to submit a written statement (known as a "Wells Submission") to the SEC to counter the staff's recommendation. The city advised us that it issued its Wells Submission on December 7, 1995, and denied violating federal securities laws in connection with the financing of DIA.

Also, in February 1995 and March 1995, four class action lawsuits were filed in United States District Court for the Colorado District by DIA bondholders seeking damages from the City and County of Denver. The four lawsuits allege that the city misrepresented the design and construction status of the automated baggage system and the opening date of DIA. In addition, two of the lawsuits make allegations that the city and other defendants engaged in a conspiracy to conceal adverse facts from the investing public in order to artificially inflate the market price of the bonds. On May 1, 1995, a class action complaint was filed in Denver District Court by the four plaintiffs in the federal court cases, making substantially similar allegations. An SEC determination resulting from its investigation that disclosures were not fair or complete could aid litigants claiming losses from improper disclosures.

Other Key Risks

In its Official Statement published in June 1995 to promote bond sales, DIA noted several investment risk factors that could potentially affect the security of DIA bonds, including the ongoing SEC investigation and bondholder litigation discussed above. In addition, we have summarized the following risk factors from that statement as items that must be noted as part of any analysis of DIA's long-term financial condition.

- DIA estimates operating revenues of about $500 million per year for the period 1995 to 2000, and anticipates receiving federal grants in amounts adequate to retire $118 million in subordinate bonds over the 5-year period. Grants require congressional action that cannot be assured.
- Many of the airlines operating at DIA, including United, Continental, Delta, Northwest, TWA, and others, have sent letters objecting to various aspects of the rates and charges for the airport. DIA officials stated that only TWA has filed a complaint with DOT, and DOT resolved TWA's complaint in favor of the City of Denver.
- Other factors that will affect aviation activity at DIA include (1) the growth of the economy in the Denver metropolitan area, (2) airline service and route networks, (3) national and international economic and political conditions, (4) the price of aviation fuel, (5) levels of airfares, and (6) the capacity of the national air traffic control system.

DIA's Ability to Meet Its Financial Obligations

Based on our review of DIA's long-term budgets and the data available on actual operations from its opening on February 28, 1995, through August 31, 1995, we found no significant issues which would lead us to believe that DIA will be unable to meet its financial obligations. However, the risks we identified in the previous section must be carefully considered by users of our report.

Passenger enplanements are a key measure primarily because United Airlines, which accounts for over 70 percent of DIA passengers, has an agreement with DIA that it will honor its lease as long as costs per enplaned passenger do not exceed a specified level. DIA's leases also include a rate maintenance agreement that allows it to charge rates and fees sufficient to cover DIA's debt service and operating costs. Thus, the effectiveness of this agreement in supporting DIA's ability to meet its obligations is based upon maintaining the level of enplanements and costs per enplaned passenger within limits specified by the United lease agreement.

During its initial 6 months of operations, DIA's volume of enplaned passengers averaged 95 percent of estimates. Both DIA and the Federal

Aviation Administration (FAA) expect enplanement levels to increase over the next 5 years. Although leases were below anticipated levels due to Continental Airlines' removal of its hub from Denver and MarkAir's bankruptcy, DIA estimates that it will have positive net revenues of $19.5 million for 1995. Debt service requirements have been spread relatively evenly over the next 30 years. DIA's current budgeted operating costs were based on contractual agreements and detailed budgets. DIA expects these operating expenses to increase with the levels of inflation over the next 30 years. DIA posted positive cash flows during the period under review and has adequate cash reserves to draw on in case of emergency in the immediate future.

Passenger Volume

DIA's ability to generate sufficient revenues to cover its operating costs and debt service requirements ultimately depends upon the number of passengers that choose to use the airport. Passenger volume dictates airline demand for space at DIA and is directly linked to the financial success or failure of DIA concessions.

We analyzed airline landing reports for the first 6 months of operations at DIA and found that its volume of enplaned passengers was about 95 percent of its estimates. DIA and FAA both expect enplanement levels to increase in future years. Provided DIA does not suffer a significant decline in passenger levels, a risk we previously discussed, and have unanticipated costs, it should be able to keep its cost per enplaned passenger within the limits specified by its lease agreement with United Airlines.

In October 1995, DIA estimated that passenger enplanements for 1995 would be 15.9 million,[6] while FAA estimated that they would be 15.1 million. Both estimated that enplanements would rise from 1995 to 2000, reaching 18.2 million in 2000. DIA estimated an annual growth rate of about 2.6 percent in passenger volume from 1995 through 2000, while FAA estimated an annual growth rate of about 4 percent from 1995 through 2010.

United Airlines has an agreement with DIA that it will honor its 30-year lease as long as costs per enplaned passenger do not exceed $20, measured in 1990 dollars. In June 1995, DIA estimated that United's cost per enplaned passenger in 1995 would be $16.31 in 1990 dollars and, if enplanement levels approximate estimates and unanticipated costs are not incurred, would drop to $13.22 by the year 2000. In our October 1994

[6]As of the February 28, 1995, opening date at DIA, 16,135,000 passengers were estimated for 1995.

report,[7] we estimated that, with all other factors remaining constant, passenger traffic would have to drop to between 12 million and 12.5 million enplaned passengers in 1995 to drive costs above $20 per enplaned passenger.

Net Revenues

DIA has three concourses containing a total of 90 jet gates; however, as of September 1, 1995, only 76 of the gates were being used by airlines, with 69 of them covered by lease agreements. DIA is operating substantially below capacity due to Continental Airlines' decision to remove its hub from Denver and, to a lesser extent, MarkAir's bankruptcy and failure.

Although this reduced the level of operations, DIA's reports show that it has covered its costs and achieved positive cash flows for its first 6 months. Following DIA's April 1995 agreement allowing Continental to reduce its lease commitment from 20 gates to 10, DIA raised its rental rates to airlines, effective May 1, 1995, by 6.8 percent. Other airlines, primarily United, have increased passenger volume due to Continental's pullout. In addition, reported operating costs have been below budget. All these factors have contributed to DIA's positive financial results to date. Furthermore, because DIA is operating below capacity, it is positioned to meet the expected increase in passenger volumes in future years without constructing new facilities.

DIA's 14 idle gates were all on concourse A, which was planned to support Continental Airlines' hubbing operation. Continental entered into an agreement with DIA in August 1992 to lease 20 of the 26 gates on concourse A but had eliminated most of its Denver operations by the time DIA opened in 1995. In April 1995, Continental's lease commitment was reduced to 10 gates for 5 years. Further, Continental was allowed to sublease up to 7 of these gates. As of September 1, 1995, Frontier was subleasing 4 gates and America West was subleasing 1 gate from Continental. Two other gates on concourse A were used by Mexicana Airlines and Martinair Holland.

All 44 gates on concourse B were leased by United Airlines for 30 years. The 20 gates on concourse C were used by various airlines, with 13 gates leased as of September 1, 1995, generally under 5-year leases. The remaining seven gates were used by non-signatory airlines. Airlines operating on a non-signatory basis pay 20 percent higher rates for space rent and landing fees and do not share in the year-end dividend based on 80 percent of DIA's net receipts. Five of those unleased gates on concourse

[7] New Denver Airport: Impact of the Delayed Baggage System (GAO/RCED-95-35BR, October 14, 1994).

C were used by MarkAir, which filed for bankruptcy in April 1995. In October 1995, MarkAir went out of business, owing DIA about $2.9 million.

DIA also hosts a substantial air cargo operation. It has lease agreements with several major cargo carriers, including Federal Express, United Parcel Service, and Emery Worldwide. According to DIA's estimate, which we reviewed and found reasonable, this operation was to produce $3.3 million in space rent plus about $5 million in landing fees for fiscal year 1995.

DIA's Operating Costs

Debt service requirements and operations and maintenance are DIA's two major cost components. Debt service costs are expected to remain relatively stable over the next 30 years. Operating costs are expected to rise with inflation over that time frame.

Debt Service Requirements

Debt service payments constitute over 60 percent of DIA's estimated annual costs. DIA's bonds are scheduled to be paid off in relatively equal installments over the next 30 years. After a bond sale in June 1995, DIA had bonds payable of about $3.8 billion. DIA's June 22, 1995, estimates included two future bond sales to finance capital improvements. The first of these sales, held on November 15, 1995, after the end of our review, yielded $107,585,000 in bond principal. The second sale was scheduled for January 1, 1997, for $40,835,000 in bond principal.

Based on its current contractual agreements with bondholders and estimated servicing requirements on the two additional bond sales, DIA's cash requirements for servicing the debt on its bonds will be spread relatively evenly over the next 30 years. Annual bond payments will rise from about $288 million in fiscal year 1996 to about $327 million in fiscal year 2005. From fiscal years 2006 through 2024, the payments are to range from $307 million to $329 million, with a final bond payment in fiscal year 2025 totaling $267 million.

Operations and Maintenance Costs

In addition to debt service payments, operations and maintenance and other expenses of the Denver Airport System (including upkeep of Stapleton International Airport) comprise DIA's other major cost element. DIA estimated that these costs would be about $159 million in fiscal year 1996 and would increase by about 3 percent a year as a result of inflation. Table 1 lists DIA's estimated operations and maintenance costs for fiscal year 1996 by cost category.

Table 1: DIA's Estimated Operations and Maintenance Costs for Fiscal Year 1996 by Cost Category

Cost category	Estimated cost
Personnel	$44,125,000
Cleaning	20,648,000
Utilities	19,438,000
Supplies and materials	9,681,000
Repairs and maintenance	8,374,000
Professional services	8,099,000
Police	7,726,000
City interfund services	7,014,000
Stapleton International Airport	5,749,000
Underground train	5,662,000
Variable rate bond fees	5,142,000
Aircraft rescue and fire fighting	5,012,000
Management fees	4,001,000
Shuttle bus services	3,120,000
De-icing facility management fee	2,027,000
Other contractual services	1,431,000
Fuel line fill-up	985,000
Miscellaneous	455,000
Total	**$158,689,000**

Source: DIA data as of June 1, 1995. GAO examined all budget estimates exceeding $1 million and concluded they were reasonable.

We reviewed DIA's budgets for operations and maintenance costs by category and found the estimated amounts to be reasonable and supported by adequate documentation. Many cost categories were supported by contracts for services, including cleaning services, parking system management, and operation and maintenance of the underground train. Other categories were based on detailed, documented budgets that were developed using data such as number of employees, utility costs per square foot of building space, and other standard estimating methods. Estimates beyond the current year are based on 1996 estimates that were adjusted for a reasonable inflation factor.

DIA Cash Flows

Estimates and analyses of short- and long-term cash flows are valuable financial management tools, especially when cash flows are volatile or uncertain—for example, when an operation is just getting underway or during periods when significant construction and capital improvement programs are being carried out. Used in conjunction with an entity's other important financial reports, cash flow estimates and statements provide useful analytical information. For example, comparing cash flows with accrual-based accounting information can yield valuable management information.

In response to our request, DIA prepared estimates of cash flows for fiscal years 1996 through 2000. In April 1995, DIA officials also provided estimates of cash flows by month for 1995. We compiled DIA's actual cash flows for March through May 1995 and found that DIA produced a positive cash flow of $1.5 million in its first 3 months of operations.[8]

In September 1995, DIA's finance office provided us with cash flow statements it prepared for March through August 1995. The statements showed a positive cash flow of $1.8 million for March through May, which approximates the results of our analysis, and $12.1 million for June through August 1995. We confirmed that the statement's $49.9 million ending cash balance as of August 31, 1995, matched the balance on DIA's general ledger.

At the time of our review, DIA officials said they were not required to prepare long-term cash flow estimates or statements. DIA's Finance Director told us that DIA did not use long-term cash flow estimates and analysis to assist in managing DIA operations. She stated that financial information available on the accrual basis of accounting was not materially different from information available on the cash basis and, in DIA's view, is sufficient for long-term planning. Finally, she stated that DIA's rate maintenance covenant ensures that DIA will generate adequate receipts to cover all disbursements.

We surveyed seven airports about their use of cash flow estimates as a management tool. Two of the seven stated that they use cash flow estimates. For example, an Atlanta airport official stated that cash flow estimates were particularly valuable in its new concourse construction program. The five airports that did not use cash flow analyses had stable operations that experienced minimal fluctuations from year to year in receipts and disbursements.

[8]Short-term fluctuations in cash receipts and expenditures can affect the usefulness of a 3-month cash flow analysis. For example, United Airlines paid $4.56 million on June 2, 1995, for landing fees that were due on May 15. Had DIA received this payment prior to May 31, the cash flow analysis would have reported a positive cash flow of about $6 million.

In commenting on a draft of this report, DIA's Director of Aviation reiterated DIA's position that cash flow estimates beyond the current fiscal year are not useful for several reasons and that the airport's 5-year feasibility study is an adequate long-term planning tool. We believe, however, that cash flow estimates would have been a valuable management tool during the period of our review as DIA completed construction. Also, in conjunction with DIA's other financial data, such estimates could continue to provide useful analytical data as the airport's operations stabilize during its initial years of operations.

DIA's comments also stated that weekly cash flow estimates had been prepared since January 1994 and that weekly estimates were rolled up into monthly and quarterly reports. During the course of our work, we made repeated requests for such estimates, including a writen request on January 27, 1995. In a letter dated February 2, 1995, DIA's Assistant Director of Aviation for Finance advised us that the monthly cash flow estimates for 1995 had not been completed. As stated earlier in this section, we did not receive DIA's estimates of cash flows for fiscal year 1995 by month until April 1995.

DIA Cash Reserves

As of September 25, 1995, the date of DIA's latest available reserve fund statement, DIA had an operating cash balance of $57 million and held $420 million in reserve funds. In the event of a temporary financial crisis, about $260 million of these reserve funds could be used, subject to certain restrictions. Table 2 presents DIA's reported reserve fund balances as of September 25, 1995.

Table 2: DIA Reserve Funds as of September 25, 1995

Reserve fund	Balance
Bond	$312,801,299
Capital	47,548,054
Coverage	47,000,000
Operations and maintenance	12,462,998
Total	**$419,812,351**

The following restrictions apply to the use of the reserve funds:

- Bond Reserve Fund. Under terms of the bond ordinance, money can be withdrawn from this fund only to meet debt service requirements. Withdrawn funds must be paid back at the rate of 1/60th of the amount owed each month. Our analysis showed that about $200 million could be withdrawn from this fund before the payback requirements would exceed the remaining balance. However, according to bond analysts to whom we spoke, drawing on this fund could have a negative effect on DIA's bond ratings if DIA seeks future bond financing. As previously discussed, only one additional bond sale is currently being planned.

- Capital Fund. This fund can be used without restriction to pay for capital improvement costs, extraordinary costs, or debt service requirements. DIA anticipates that in the ordinary course of business, it will draw upon this fund for capital improvements.
- Coverage Fund. DIA's rate maintenance covenant requires that net revenues of the airport, combined with the coverage fund, equal no less than 125 percent of the debt service requirement on senior bonds for the upcoming year. The coverage fund amount is calculated at the end of each year and must be fully funded at that time. In June 1995, DIA reported that the December 31, 1996, coverage fund requirement will be $58.4 million. Any amounts withdrawn from the coverage fund must be replenished by December 31 of each year, which effectively limits the use of this fund in a financial crisis.
- Operations and Maintenance Reserve Fund. This fund must be fully funded by January 1, 1997. Full funding requires that 2 months of operations and maintenance expenses be on deposit in the fund, a requirement of about $27 million. This fund can be used to cover operations and maintenance expenses if net cash from operations is inadequate.

We requested written comments on a draft of this report from the Secretary of Transportation and the Director of Aviation, DIA, of the City of Denver. A representative of the Secretary advised us that the Department of Transportation had no comments on the report. DIA's Director of Aviation provided us with written comments, which are incorporated in the report as appropriate and reprinted in appendix I.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary of Transportation; the Director, Office of Management and Budget; officials of the City of Denver; and interested congressional committees. We will also make copies available to others upon request.

Please contact me at (202) 512-9542 if you or your staff have any questions. Major contributors to this report are listed in appendix II.

Sincerely yours,

Lisa G Jacobson

Lisa G. Jacobson
Director

Comments From Denver International Airport

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

COUNTY OF DENVER SEAL

WELLINGTON E. WEBB
Mayor

CITY AND COUNTY OF DENVER

DEPARTMENT OF AVIATION

James C. DeLong
Director of Aviation

Denver International Airport
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January 22, 1996

Mr. Gene L. Dodaro
Assistant Comptroller General
Accounting and Information Management Division
United States General Accounting Office
Washington D.C. 20548

Dear Mr. Dodaro:

There are risks inherent with any business venture and related financial projections. The overall volatility of the airline industry could impact the financial performance of Denver International Airport. However, the risks associated with the financial health of the major carrier, United Airlines, are offset by several factors.

First, Denver has a very strong Origination and Destination (O&D) market. For the first eleven months of 1995, 58.4% of the passengers were O&D. Denver is the largest center of business in, and the transportation hub for, the multi-state Rocky Mountain region. Of the connecting traffic, 33% is related to regional connecting traffic. This demand, as well as O&D traffic, totals approximately 72% of the annual enplanements. It would, in all likelihood, be serviced by another air carrier if United should reduce or eliminate operations in Denver.

Second, the Denver economy remains strong. 1995 was the ninth consecutive year Colorado experienced job growth, reflecting the diverse economy of the state. Colorado has outpaced the national employment growth rates since 1989. In November 1995, Fortune ranked Denver the third best city in the U.S. for business. Denver's independent financial consultant projects an overall 2.7% annual growth rate in passenger traffic through the year 2000, in part due to the strong economic condition of the region.

See comment 1.

United and United Express carriers did service about 69% of the total passengers at DIA through November 1995. They service about 66% of the combined regional connecting and O&D traffic. United Airlines has reported strong profits in 1994 and 1995. United had a net profit of $243 million for the third quarter in 1995. This is net of costs incurred at Denver. Denver International Airport is an extremely efficient airport. Airline estimates for operational savings are about $27 million per year. A portion of these projected savings result from reduced delays at DIA. FAA reports dated March 29, May 9, and June 14, 1995, state that DIA is performing seven times more efficiently than Stapleton, and that it has exceeded expectations in every area of performance. This was further discussed in a recent article released by Bloomberg Business News attached.

See comment 2.

Mr. Gene L. Dodaro
January 22, 1996
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The report indicates that the airport has not prepared cash flow estimates or statements prior to the GAO inquiry and that the airport indicated they were not a useful management tool. In fact, weekly cash flow statements have been prepared since January 1994. These weekly statements are reviewed each week by the finance director. Weekly statements are rolled up into monthly and quarterly reports. Any significant fluctuations are investigated. In March, 1995, a complete cash flow forecast was prepared based on the new airport rates and charges. This was modified in April, 1995, as a result of the agreement with Continental and United which materially changed the rates and charges assessed the airlines. Monthly cash flows have been compared to the projections since March, 1995.

While cash flow forecasts and statements can be a useful analytical tool, it is not the only or the most important financial indicator. Other equally important financial tools that the airport utilizes include: a) accounts receivable aging reports, b) monthly budget/actual reports by division, c) quarterly financial statements, d) fund status reports and investment reports, and e) revenue analysis by type. These reports combined with cash flow statements provide a comprehensive analysis of the current financial condition of the airport.

For long-term financial planning and analysis, beyond the current fiscal year, the airport has employed an independent financial consultant to prepare a five-year feasibility study. This study projects revenue and expenses on an accrual basis thereby reflecting revenues in the period earned and expenses in the period incurred. In addition, the feasibility reflects debt service in the period incurred, including principal payment requirements. This analysis is a far better assessment of the financial position and issues than a cash flow projection.

Furthermore, cash flow projections beyond the current fiscal year are not useful for the following reasons: a) assumptions become more subjective and less reliable, b) there are no material changes in the cash resources or requirements from year to year, and c) the airport has approximately $450 million in cash reserves to handle financial crises including two months operation and maintenance expenses and a full year of debt service. In management's opinion, the five-year feasibility study is an adequate long-term planning tool.

Very truly yours,

James C. DeLong
Manager of Aviation

JCD/DD/sh

Attachment

The following are GAO's comments on the letter from Denver International Airport's Director of Aviation dated January 22, 1996.

GAO Comments

1. See the "Health of the Airline Industry and United Airlines" section of the report. Also, we did not reprint the referenced article.

2. See the "DIA Cash Flows" section of the report.

Major Contributors to This Report

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