



Fairfax County Internal Audit Office

Facilities Management Department
Lease Management Audit
Final Report

July 2016

"promoting efficient & effective local government"

Executive Summary

The Facilities Management Department (FMD) negotiates and manages expenditure property lease contracts on behalf of other county agencies and programs to meet their needs for office and/or warehouse spaces. FMD also manages revenue telecommunication/space lease contracts, which lease Fairfax County Board of Supervisors-owned property for telecommunications facilities and/or services and unused space to outside organizations. FMD works closely with Jones, Lang and LaSalle (JLL), a real estate advisor, to better understand the local commercial real estate market conditions and rental rates. Both expenditure property lease contracts and revenue lease contracts payments are set up and recorded in FOCUS. The fiscal year 2015 annual rental cost for expenditure lease contracts was \$16.3 million; annual rental income for revenue space lease contracts was \$3.5 million; and revenue generated from telecommunication property lease contracts was \$844K.

This audit focused on the adequacy of controls over FMD's property leasing management operations for rental payment and revenue collection processes. We noted that rental payments were paid timely and accurately and lease expenditures were properly authorized and in compliance with the terms in lease contracts. Additionally, the lease contracts reviewed were renewed on time, and no payments were made on expired leases. Also, the staff who negotiated and administered leases did not have any conflicts of interest. However, we noted the following exceptions where compliance and controls could be strengthened:

- Monthly reconciliation for expenditure lease payments was performed by the same person who submitted the payments request and processed rental payments in FOCUS. Additionally, the monthly revenue lease payments reconciliation was performed by the same staff who collected the checks and recorded the payments in FOCUS. Also, there was not sufficient separation of duties between the person who processed the Worked Performed for Others (WPFO) payment transfer vouchers in FOCUS and the person who performed the reconciliation. Finally, there was no evidence that a supervisory review of the reconciliations was performed.
- FMD did not perform the revenue lease payments monthly reconciliation in a timely manner.
- Of the eight sampled expenditure leases contract annual expense reconciliation documentation reviewed, two did not have the 2014 calendar year annual reconciliation documentation.
- Of the 20 most recently signed expenditure lease contracts reviewed, 10 samples did not have the agency's written lease space requests on file; 6 samples did not have contract supporting documents such as FMD's research to identify market rental rates, JLL's list of potential spaces, and contract negotiation documents on file. Additionally, one sample did not have the lease budget and funding approval document on file.

- We were not able to verify the accuracy and completeness of the payments made to FMD by a tenant in one of the six telecommunications revenue lease payment samples reviewed. The tenant subleased the space to a third party who was required to pay 40% of the sublease income to the County based on the lease contract between the County and the tenant. The tenant underpaid the sublease amount due to the County from March 2010, through November 2014. The total underpayment was \$21,072 which the tenant found through its own independent review. Due to the way the contract was written, there was no legal requirement for the sub-lessor to provide any documents to verify the amount. Per staff, for future telecommunications revenue lease contracts, instead of collecting sublease revenue from the tenant, FMD will charge the tenant a flat fee with 3% escalation.
- FMD did not endorse the expenditure lease payment checks upon receipt. FMD also did not maintain a check log to record the check receiving date, check number, check amount, etc. Additionally, the lease payment checks were not made to the DOF depository in a timely manner. These checks were kept in the staff's desk drawer for a few days before they were sent to the Department of Finance (DOF) for depositing. Finally, FMD did not have written documented check processing procedures.

Scope and Objectives

This audit was performed as part of our fiscal year 2016 Annual Audit Plan and was conducted in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit covered the period of October 1, 2014, through September 30, 2015, and our audit objectives were to determine:

- Whether county pays a fair rental market rate.
- Staff who negotiate and administer leases do not have any conflicts of interest.
- Lease payments are processed accurately and timely.
- Lease contracts are renewed on time and no payments are made on expired lease contracts.
- Lease expenditures are properly authorized and in compliance with the terms in lease contracts.
- Space lease and telecommunication lease revenues are collected on time.

Methodology

Our audit approach included interviews of appropriate staff, walk through of various work functions, and detailed testing of lease contracts and payment transactions samples. We

also evaluated the processes for compliance with sound internal controls as well as county and departmental policies and procedures.

The Fairfax County Internal Audit Office (IAO) is free from organizational impairments to independence in our reporting as defined by Government Auditing Standards. We report directly and are accountable to the County Executive. Organizationally, we are outside the staff or line management function of the units that we audit. We report the results of our audits to the County Executive and the Board of Supervisors, and IAO reports are available to the public.

Findings, Recommendations, and Management Response

1. Separation of Duties/Supervisory Review

We reviewed the expenditure and revenue lease payments and WPFO payments reconciliation documentation within the scope of our audit and noted the following:

- a. The monthly expenditure lease payments reconciliation was performed by the same person who submitted the payments request and processed rental payments in FOCUS.
- b. The monthly revenue lease payments reconciliation was performed by the same staff who collected the checks and recorded the payments in FOCUS.
- c. Staff who processed the WPFO payment transfer vouchers in FOCUS, also performed the reconciliation.
- d. There was no evidence that a supervisory review of the reconciliations of the above items was performed.

The Accounting Technical Bulletin (ATB) 020, *Reconciliation of Financial Transactions*, states: "...an individual should not have complete control over all aspects of a financial transaction. For example: *An employee who is directly responsible for recording receipts or invoices for payment in FOCUS should not also perform the reconciliation of the same financial transaction posted to FOCUS* . If separation of duties cannot be achieved in the performance of the reconciliation, a supervisor should perform a detailed review of the transaction activity. The supervisor must sign and date the document reviewed. Adherence to the two-person rule, which provides that no one person may both initiate and approve the same document, must be monitored and enforced."

Controls are weak or non-existent when there is a lack of segregation of duties between the person who makes the payment and records it in FOCUS and the person who performs the reconciliation function. Additionally, failure to adequately document the completion of reconciliations and the supervisory review weakens the ability to evidence that an effective separation of duties is in place. It also increases the risk that unauthorized or erroneous transactions could go undetected or not be corrected in a timely manner.

Recommendation: We recommend FMD implement the segregation of duties control between the person who makes the payment, collects the checks and records it in FOCUS, and the person who performs the reconciliation function. If separation of duties could not be achieved, a supervisory review should be performed. Additionally, the supervisor must sign and date the document reviewed. Finally, adherence to the two-person rule, which provides that no one person may both initiate and approve the same document must be monitored and enforced.

Management Response: Supervisory review will be conducted as part of the reconciliation process. Supervisory signature and date to be indicated on the Reconciliation Certification Form. Additionally, FMD will adhere to the two-person rule. Management anticipates completing this item by July 29, 2016.

2. Timeliness of Revenue Lease Payments Monthly Reconciliation

FMD did not perform any reconciliations of the expenditure and revenue lease payments, as well as WPFO transactions in the past. Per staff, FMD started to perform the reconciliations in July 2015. Reconciliations of expenditure lease payments and revenue lease payments were to be performed on a monthly basis, and reconciliation of WPFO payments should be performed either on a quarterly or annual basis depending on the type of payment. We reviewed the revenue lease payments reconciliation documentation for the months of July, September and November of 2015 and noted that all three revenue lease payments reconciliations were performed later than the DOF recommended timeline which is no later than the last day of the following month. For example, the reconciliation for the month of July was performed in October and the reconciliation for the month of September was reconciled in November.

ATB 020, *Reconciliation of Financial Transactions*, states: "Perform monthly reconciliations on a timely basis (no later than the last day of the following month) at the transaction level. These reconciliations are to be carried out in accordance with the department's reconciliation plan that has been approved by DOF. Any discrepancies discovered while reconciling should be immediately investigated, explained and, if required, corrected."

Failure to perform a timely monthly reconciliation could lead to unauthorized or erroneous transactions going undetected or not being corrected in a timely manner.

Recommendation: We recommend FMD perform reconciliation activities in a timely manner, which is no later than the last day of the following month. Documentation supporting the reconciliation should be maintained and the reconciler should sign and date documents settled to evidence that the reconciliations are being performed in a timely manner.

Management Response: We will follow Audit's recommendation to reconcile lease payments within thirty (30) days of payment.

Per FMD, this recommendation has been implemented, however, IAO will perform a follow-up review to verify the implementation status.

3. Expenditure Lease Payments Annual Expense Reconciliation

Of the eight sampled expenditure lease contract annual expense reconciliation documentation reviewed, two did not have the 2014 calendar year annual reconciliation documentation. Additionally, FMD did not follow up with the landlord when they failed to deliver the annual expense statements in a timely manner.

- Contract # 1: FMD was not able to provide the contract's annual reconciliation documentation and the annual statements for the calendar year 2014. Per FMD staff, the agency contacted the landlord property manager and was able to obtain the 2014 annual statements in March, 2016. Additionally, staff noted that the agency had been communicating with the landlord property manager about the discrepancies on the statements but the reconciliation was not finalized as of the course of this audit. IAO did not receive a copy of landlord's annual expense statements during the audit.
- Contract # 2: Per FMD staff, the agency received the 2014 annual statements in May 2015; however due to disagreement with the annual statements the reconciliation was not finalized. During the audit, FMD met with the new property manager on March 15, 2016 to discuss the statements and finalized the reconciliation. IAO verified that the reconciliation was finalized.

For most expenditure lease contracts, the contract requires landlord to submit the "operating expense statement" and "taxes expense statement" within 150 or 180 days after the expiration of each calendar year. The expense statements state the actual operating expense, the actual real estate taxes and the tenant's share of such actual expenses. The tenant shall pay to landlord any deficiency within 30 days after the delivery of such statements. If tenant's payment exceeded the actual expenses, the excess amount shall be applied against the next due payments. The annual statements should be reviewed to ensure the expenses charged to the County are accurate.

Lack of a timely annual reconciliation performance could lead to overpayment of unauthorized or erroneous expenses that are undetected. Additionally, if there are any excess operation expense payments, the payments will not be refunded on time.

Recommendation: FMD should ensure that landlord submits their annual tax expense statement and operating expense statement on time, and resolves any disagreements/discrepancies within 30 days after receiving the statements unless a dispute arises in which both parties agree to extend the allotted time. However, any time extension should be documented with proper justification.

Management Response: FMD will follow up with landlords to ensure annual expense statements are submitted on time, but FMD will require up to ninety (90) days to resolve the disagreements/discrepancies because the property managers often

miscalculate the operating expenses owed per the lease terms.

Per FMD, this recommendation has been implemented, however, IAO will perform a follow-up review to verify the implementation status.

4. Supporting Documentation

We selected the 20 most recently signed expenditure contracts and reviewed the contracts' supporting documentation to determine whether controls were in place to ensure County did not pay above market rental rates. We found 10 out of 20 samples did not have agency's written lease space requests on file; 6 out of 20 samples did not have contract supporting documents such as FMD's own research to identify market rental rates, JLL's list of potential spaces, or contract negotiation documents on file. Additionally, the lease budget and funding approval document was not on file for one of the 20 samples reviewed.

According to *Virginia Public Records Policies for Records Retention and Disposition*, the scheduled retention period for contract and supporting documentation is 5 years after contract expiration.

Additionally, per Procedural Memorandum (PM) No. 25-20, *Amendment 3, Leasing of Office or Other Commercial Real Estate*, "County agencies that need to lease office space or other commercial real estate shall submit a written request to the County Executive through their respective Deputy County Executive with a copy to the Chief Financial Officer and Deputy County Executive responsible for FMD."

Maintaining sufficient contract supporting documentation on file provides reasonable assurance that a thorough research is performed to identify a fair market rental rate, and that the leasing space complies with agency's request.

Recommendation: We recommend FMD maintain sufficient supporting documentation to demonstrate that steps are taken to research and identify the market rental rate and to ensure county pays a fair rental fare before entering in a lease contract. Additionally, the supporting documentation provides evidence that the process of seeking lease space is legal and transparent.

Management Response: FMD will store electronic copies of the supporting documentation for the determination of the market rental rate. FMD will also generate a new standardized Lease Requirements Form and will require all agencies requesting space to complete this form before beginning any search or negotiations. Management anticipates completing this item by October 1, 2016.

5. Telecommunications Revenue Lease Payments

IAO was not able to verify the accuracy and completeness of the payments made to FMD by a tenant in one of the six telecommunications revenue lease payment samples reviewed. The tenant subleased the space to a third party who was required to pay 40% of the sublease income to the County based on the lease contract

between the County and the tenant. However, FMD didn't have a copy of the sublease between its tenant and the third party. We found that the tenant underpaid the sublease amount due to the county from March 2010, through November 2014. The total underpayment was \$21,072 which the tenant found through its own independent review. The full amount was paid to the County in December 2014. According to FMD staff, the agency did not have to reconcile the payments received from the sublease. Due to the way the contract was written, there was no legal requirement for the sub-lessor to provide any documents to verify the amount. Per staff, for future telecommunications revenue lease contracts, instead of collecting sublease revenue from the tenant, FMD will charge the tenant a flat fee with 3% escalation.

The County should monitor and ensure that tenants are in compliance with lease terms, including but not limited to rent collections, and act accordingly in the event of noncompliance.

Failure to properly review and monitor the sub lessee's payment to the county increases the risks of erroneous payments and revenue loss.

Recommendation: We recommend FMD request the primary tenant to provide a copy of the sublease contract to the County. However, we recognize that the tenant is not legally required to provide the County a copy of the sublease contract based on the current contract terms. Moving forward for the new telecommunications revenue lease contracts, FMD should change the contract language to ensure the County has the right to verify the payment amount per the contract terms. Additionally, FMD should review the payments made by the tenant to ensure it is accurate and complies with the lease terms.

Management Response: FMD has recently generated a new form for telecommunications agreements that bases the rental amounts on fixed percentage escalations rather than increases based on the Consumer Price Index or share of the tenant's or subtenant's profits. FMD will also review in a timely fashion all payments made by telecommunications providers for accuracy.

Per FMD, this recommendation has been implemented, however, IAO will perform a follow-up review to verify the implementation status.

6. Check Processing

FMD did not endorse the expenditure lease payment checks upon receipt. FMD also did not maintain a check log to record the check receiving date, check number, check amount, etc. Additionally, the lease payment checks were not made to the DOF depository in a timely manner. These checks were kept in the staff's desk drawer for a few days before they were sent to DOF for depositing. Finally, FMD did not have written documented check processing procedures.

Financial Policy Statement (FPS) 470, Processing Monetary Receipts, requires that: "All checks are to be endorsed "For Deposit Only" along with the department/program

name. This can either be by hand or with an approved endorsement stamp. Failure to log and restrictively endorse checks received in the mail decreases accountability, increases the risk of errors due to misplaced checks and increases the potential for check fraud.”

Additionally, *FPS 470* recommends that “fireproof and waterproof safes be used to store cash, checks, and other valuables. A combination restricted to as few staff as possible. Filing cabinets or desk drawers with key-locks are not recommended for this purpose.”

In the absence of a check log, it would be difficult to determine when funds were received and whether they were deposited on time. Also, storing checks in a desk drawer without being endorsed and for a long period of time increases the risk of checks being lost or stolen.

Recommendation: We recommend FMD maintain an accurate log of checks received and ensure the checks are restrictively endorsed upon receipt. The log should indicate the date check was received, the check number, the amount, the payee, and the reason for payment. Additionally, checks should be deposited into County bank account in a timely manner. We also recommend FMD use a fireproof and waterproof safe to store the checks. Finally, FMD should develop written documented check processing procedures and communicate the procedures with the staff.

Management Response: Endorsement stamp ordered and received. Checks are being endorsed, compliant with FPS 470. Fire and waterproof safe ordered. Check log to be developed. Entries to be initiated by the Administrative Assistant responsible for the distribution of mail. Management anticipates completing this item by July 31, 2016.