

INTERNAL AUDIT REPORT

2015-01

Municipal Leases

Real Estate Department

March 3, 2015

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Mayor Dan Sullivan

March 3, 2015

Honorable Mayor and Members of the Assembly:

I am pleased to present for your review **Internal Audit Report 2015-01; Municipal Leases; Real Estate Department**. A brief summary of the report is presented below.

In accordance with the 2014 Audit Plan, we have completed an audit of Municipal leases managed by the Real Estate Department. The objective of this audit was to determine if general government leases were properly executed and monitored to ensure that they were current and that payments were received in accordance with the leases. Specifically, we identified general government leases managed by the Real Estate Department and reviewed them to determine if there were adequate controls regarding lease management. In addition, we contacted other Municipal Departments to identify general government leases managed by them and reviewed those leases to determine if they were properly monitored by the responsible Municipal Departments.

Based on our review, it is our opinion the administration of general government leases needs improvement. Specifically, Anchorage Municipal Code was not current regarding responsibility over lease administration. The Real Estate Department did not have adequate controls to track leases and lease payments. Eight of 47 leases we reviewed had expired, but the lessees were still using the properties and penalty clauses were not always enforced. In addition, insurance requirements found in the lease agreements were not always enforced and 14 of 45 leases requiring insurance did not have a current insurance certificate in the lease file. Also, lease agreements were not always properly amended; lease rates were not always adjusted for some leases as required in the lease agreements; and cash receipts were not always deposited daily. Finally, the Real Estate Department did not have procedures for managing leases.

There were ten findings in connection with this audit. Management was responsive to the findings and recommendations.

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Introduction. The Heritage Land Bank (HLB) and Real Estate Services are Divisions of the Real Estate Department. These two Divisions utilize the same staff. The HLB was established in 1983 to manage uncommitted Municipal lands acquired from the State of Alaska through the Municipal Entitlement Act for the benefit of present and future residents of Anchorage. Municipal land includes residential, commercial, industrial, recreational and open space areas. Real Estate Services maintains and manages land for other Municipal departments and lands not in the HLB or the Anchorage Community Development Authority.

Objective and Scope. The objective of this audit was to determine if general government leases were properly executed and monitored to ensure that they were current and that payments were received in accordance with the leases. Specifically, we identified general government leases managed by the Real Estate Department and reviewed them to determine if there were adequate controls regarding lease management. In addition, we contacted other Municipal Departments to identify general government leases managed by them and reviewed those leases to determine if they were properly monitored by the responsible Municipal Departments.

The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of October through November 2014.

Overall Evaluation. The administration of general government leases needs improvement. Specifically, Anchorage Municipal Code (AMC) was not current regarding responsibility over lease administration. The Real Estate Department did not have adequate controls to track leases and

lease payments. Eight of 47 leases we reviewed had expired, but the lessees were still using the properties and penalty clauses were not always enforced. In addition, insurance requirements found in the lease agreements were not always enforced and 14 of 45 leases requiring insurance did not have a current insurance certificate in the lease file. Also, lease agreements were not always properly amended; lease rates were not always adjusted for some leases as required in the lease agreements; and cash receipts were not always deposited daily. Finally, the Real Estate Department did not have procedures for managing leases.

Management Comments. Management stated, “The Real Estate Department has been short-staffed and without a Real Estate Manager since October, 2010. The department acknowledges the management of the leases and contracts needs improvement. The latest appointment to the department by Mayor Sullivan in July of 2013 was made to add expertise in real estate contract and lease management, along with expertise in land management and wetland mitigation. That newly appointed staff member immediately implemented a program to identify all known contracts, including leases, and to create a spreadsheet with information and critical dates. That spreadsheet was well on the way to being completed when the audit was executed. In an effort to effectively manage the Real Estate Department contracts, the department has instituted a policy that all contracts will be reviewed by the Land Management Officers on an annual basis at minimum. A contract summary form will be accomplished and tracked via log. A departmental calendar has been set-up to track activities and actions necessary to maintain and monitor all aspects of contracts, including leases. Also, a Performance Measure has been added to include the number of contracts reviewed.”

FINDINGS AND RECOMMENDATIONS

1. AMC Not Current Regarding Lease Administration.

- a. Finding.** Anchorage Municipal Code (AMC) was not current regarding responsibility over lease administration. According to AMC 25.10.030, *Powers and duties of department of property and facility management*, the Department of Property and

Facility Management is responsible for “Preparing and securing the execution of all contracts, leases, conveyances and other documents...” Under the current Municipal organization, the Department of Property and Facility Management no longer exists, but was replaced by Facility and Fleet Maintenance, with Real Estate Services being transferred from the Department of Property and Facility Management to the Real Estate Department. Our review revealed that other Departments also managed some leases. For example, since 2004 the Library has managed a lease for a café located in the Z. J. Loussac Library. A similar finding was reported in Internal Audit Report 2005-11.

- b. **Recommendation.** The Real Estate Department Director should revise AMC 25.10.030 to identify who should be responsible for the acquisition, administration and disposal of leased real property.

- c. **Management Comments.** Management concurred and stated, “There have been numerous code changes to the function and hierarchy of the Real Estate Department over the years and the department acknowledges the need to clarify the department functions.

“An ordinance is being drafted by the legal department to clearly identify the organization chart and functions of the department.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Controls to Monitor Lease Payments Not Adequate.**

- a. **Finding.** The Real Estate Department did not have adequate controls to track leases and lease payments. A similar finding was reported in Internal Audit Report 2005-11.

Specifically, tracking sheets did not include all leases and basic detail such as payment due dates, late payment fees, renewal dates, and past due payments. In addition, the tracking sheets were not always properly updated with the billing and payment information. As a result, there was no assurance that payments were made timely. For example:

- A lessee did not make a \$3,500 payment in June 2014. However, the non-payment was not discovered until October 9, 2014 when we identified it during our audit work. In addition, a \$3,000 security deposit refund was processed for the lessee, despite the June 2014 non-payment.
- A lease to study soil composition on Municipal property was not included on the lease tracking sheet. A \$2,500 advance lease payment was due in February 2014. However, as of October 2014 there was no evidence the payment was received.
- A lessee disputed a lease payment amount for several years and settled in September 2013 for \$145,479. However, the payment tracking sheet did not have a record of the payment and staff did not know if the payment was received. It was not until October 2014 that staff found a payment record indicating the payment was received a year ago in October 2013.
- A lessee had been in default since a lease agreement was made in 2009. However, staff did not know the actual default amount due since the payment tracking sheet did not have all collected lease payments.

Finally, staff sometimes used the PeopleSoft Account Receivable (PeopleSoft) module to bill and collect lease payments. Using PeopleSoft and an inaccurate lease tracking sheet made it even more difficult to adequately track and process lease payments.

- b. **Recommendation.** The Real Estate Department Director should establish controls to ensure that lease payments are made timely.

- c. **Management Comments.** Management concurred and stated, “The department acknowledges the need to monitor payment due dates, late payment fees, renewal dates, and past due payments more closely.

“A departmental calendar has been set-up to track activities and actions necessary to maintain and monitor all aspects of contracts. The Real Estate Department Director has established protocol for controls on lease payments and will continue to monitor to ensure adherence.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Expired Leases.**

- a. **Finding.** Eight of 47 leases we reviewed had expired, but the lessees were still using the properties. For example, a lease for office space in downtown Anchorage was effective through November 2004. The lease was not renewed, but the lessee continued using the property paying the same monthly rental rate of \$725. A similar finding was reported in Internal Audit Report 2005-11.

b. **Recommendation.** The Real Estate Department Director should ensure that expired leases are renewed or terminated.

c. **Management Comments.** Management concurred and stated, “In the real estate industry, there are certain circumstances when leases will continue on a month to month basis after expiration of the lease, without being terminated.

“A departmental calendar has been set-up to track activities and actions necessary to maintain and monitor all aspects of leases. The Real Estate Department Director will ensure that expired leases are renewed when applicable or terminated when applicable. If there is a reason to allow a lease to continue on a month to month basis, a memorandum will be created to place in the file with an explanation of those circumstances.”

d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **Penalty Clause Not Always Enforced.**

a. **Finding.** The penalty clause was not enforced for nine leases. For example, a payment that was due on October 1, 2014, was received on October 7, 2014. According to the lease agreement, the late payment was subject to a \$1,000 late fee. The late payment was not pursued by Real Estate Department staff.

b. **Recommendation.** The Real Estate Department Director should ensure that penalty clauses are enforced.

- c. **Management Comments.** Management concurred and stated, “The department acknowledges the need for tighter controls on monitoring and enforcing penalty clauses.

“The Real Estate Department Director will ensure that penalty clauses in leases are monitored and enforced.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. **Insurance Requirement Not Always Enforced.**

- a. **Finding.** Insurance requirements found in the lease agreements were not always enforced. Specifically, we found that 3 of 28 leases did not name the Municipality as the additional insured as required by the lease agreements and one was under-insured. In another case, there was no evidence that the lessee obtained a performance bond as required in the lease agreement. Staff were not aware of the lease agreement’s bond requirement.

- b. **Recommendation.** The Real Estate Department Director should ensure that lessees satisfy the insurance requirements.

- c. **Management Comments.** Management concurred and stated, “The department acknowledges the need for tighter controls on monitoring insurance certificates that are required by leases, along with expiration dates and insured limits.

“A departmental calendar has been set-up to track activities and actions necessary to maintain and monitor all aspects of leases. The Real Estate Department Director will ensure that lessees satisfy all of the contractual insurance requirements.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

6. **Inadequate Support for Insurance Coverage.**

- a. **Finding.** Fourteen of 42 leases requiring insurance did not have a current insurance certificate in the lease file. A similar finding was reported in Internal Audit Report 2005-11. As a result, we were unable to determine if insurance requirements were met. For example, a lease agreement was signed in February 2014. The lessee never provided a copy of the insurance certificate. On July 10, 2014, a letter was sent to the lessee requesting a copy of the insurance certificate. As of November 2014, the lessee had not provided the insurance certificate.

In addition, a lease agreement contained inconsistent language regarding required insurance coverage. According to the lease agreement, “The limits for each shall be not less than Two Million Dollars (\$1,000,000) per occurrence and Five Million Dollars (\$2,000,000) aggregate. . . .” As a result, we were unable to determine whether the lessee met the required insurance coverage.

- b. **Recommendation.** The Real Estate Department Director should ensure that lessees provide a current insurance certificate.
- c. **Management Comments.** Management concurred and stated, “The department acknowledges the need for tighter controls on monitoring and enforcing insurance certificates that are required by leases, along with expiration dates and insured limits.

“A departmental calendar has been set-up to track activities and actions necessary to maintain and monitor all aspects of leases. The Real Estate Department Director will ensure that lessees provide a current insurance certificate which satisfied all of the contractual insurance requirements.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

7. **Lease Agreements Not Always Properly Amended/Renewed.**

- a. **Finding.** Lease agreements were not always properly amended. For example, a lease agreement was signed on June 7, 2013, specifying a lease term from July 1, 2013 to June 30, 2014. Due to delays in the permitting process, the actual lease term was changed from October 1, 2013 to September 30, 2014, but the lease was not amended to reflect these dates. In another case, a lease was terminated on July 1, 2014. A letter was sent to the lessee terminating the contract. However, the lessee was allowed to use the property until September 2014, without a contract amendment to extend the contract three more months. Another lease was not renewed in a timely manner. The lease had a two year renewal term commencing on November 1, 2012, which was signed in February 2014.
- b. **Recommendation.** The Real Estate Department Director should ensure that leases are properly amended and renewed timely.
- c. **Management Comments.** Management concurred and stated, “The department acknowledges the need to ensure that leases are properly amended and reviewed timely, if possible.”

“A departmental calendar has been set-up to track activities and actions necessary to maintain and monitor all aspects of leases. The Real Estate Department Director will ensure that leases are properly amended and renewed timely. If a special circumstance arises that would not allow a lease to be amended or renewed timely, a memorandum will be created to place in the file with an explanation of those circumstances.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

8. **Lease Rate Not Always Adjusted Properly.**

- a. **Finding.** Lease rates were not always adjusted for some leases as required in the lease agreements. For example, one lease was due for a rate adjustment in 2011 and another lease was due for a rate adjustment in 2014. However, we were not able to find any evidence showing that the rates were adjusted.
- b. **Recommendation.** The Real Estate Department Director should ensure that lease rates are adjusted as specified in the lease agreements.
- c. **Management Comments.** Management concurred and stated, “The department acknowledges the need to ensure that lease rates are adjusted properly and timely.

“A departmental calendar has been set-up to track activities and actions necessary to maintain and monitor all aspects of leases. The Real Estate Department Director will ensure that lease rates are adjusted as specified in the lease agreements.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

9. **Deposits Not Always Made Daily.**

- a. **Finding.** Cash receipts were not always deposited daily. According to staff, instead of processing lease payments daily, payments were kept in a locked desk drawer during the week and deposited every Friday. However, we found a check received by HLB on August 2, 2013, was not deposited until November 22, 2013, almost 4 months later. Municipal Policy and Procedure (P&P) 24-1, *Collecting, Securing, Depositing and Reporting Cash*, states, “All Department Heads shall ensure that . . . cash received is immediately secured, accounted for, and deposited on a DAILY basis. . . .”
- b. **Recommendation.** The Real Estate Department Director should ensure that deposits are made daily as required by P&P 24-1.
- c. **Management Comments.** Management concurred and stated, “The department acknowledges the need to deposit cash receipts daily.

“The Real Estate Department Director will ensure that all deposits are made daily as required by P&P 24-1.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

10. **Real Estate Department Lacks Procedures.**

- a. **Finding.** According to Real Estate Department staff, the Real Estate Department did not have any desk procedures for managing leases. In addition, no training for managing leases was provided. As a result, there was no consistency in lease management. Many of the findings in this report could have been avoided if the Real Estate Department had comprehensive procedures.

b. **Recommendation.** The Real Estate Department Director should implement policies and procedures for managing leases.

c. **Management Comments.** Management concurred and stated, “The department acknowledges that in the past the department did not have adequate procedures or staff training for managing leases.

“The Real Estate Department Director is creating a Policy and Procedure Manual for the department to establish standard operating procedures and provide training to manage all contracts, including leases.”

d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on January 20, 2015.

Audit Staff:
Scott Lee