



INTERNAL AUDIT DEPARTMENT



**Internal Control Audit:
County Executive Office/Real Estate
Revenue Generating Lease
Administration Process**

As of April 30, 2018

**Audit No. 1730
Report Date: March 5, 2019**

Number of Recommendations

0

Critical Control Weaknesses

0

Significant Control Weaknesses

4

Control Findings

OC Board of Supervisors

Chairwoman Lisa Bartlett
5th District

Vice Chair Michelle Steel
2nd District

Supervisor Andrew Do
1st District

Vacant
3rd District

Supervisor Doug Chaffee
4th District



INTERNAL AUDIT DEPARTMENT

Internal Control Audit:
CEO/Real Estate
Revenue Generating Lease Administration Process

March 5, 2019

AUDIT HIGHLIGHTS

SCOPE OF WORK	Perform an internal control audit of CEO/Real Estate's revenue generating lease administration process for County departments for the year ended April 30, 2018.						
RESULTS	<ul style="list-style-type: none"> We found that CEO/Real Estate's internal control over the revenue generating lease administration process was generally effective to ensure CEO/Real Estate is providing adequate oversight over those leases. We found that business processes were generally efficient as related to the revenue generating lease administration process. 						
RISKS IDENTIFIED	<p>As a result of our findings, potential risks include:</p> <ul style="list-style-type: none"> Inconsistent administration of revenue generating leases. Revenue loss to the County. Undetected errors. 						
<p>NUMBER OF RECOMMENDATIONS</p> <table border="1" data-bbox="99 1360 391 1661"> <tr> <td data-bbox="99 1360 203 1461">0</td> <td data-bbox="203 1360 391 1461">CRITICAL CONTROL WEAKNESSES</td> </tr> <tr> <td data-bbox="99 1461 203 1562">0</td> <td data-bbox="203 1461 391 1562">SIGNIFICANT CONTROL WEAKNESSES</td> </tr> <tr> <td data-bbox="99 1562 203 1661">4</td> <td data-bbox="203 1562 391 1661">CONTROL FINDINGS</td> </tr> </table>	0	CRITICAL CONTROL WEAKNESSES	0	SIGNIFICANT CONTROL WEAKNESSES	4	CONTROL FINDINGS	<p>Opportunities for enhancing internal control include:</p> <ul style="list-style-type: none"> Create written policy and procedures for revenue generating lease administration. Prioritize the implementation of the Visual Lease database.
0	CRITICAL CONTROL WEAKNESSES						
0	SIGNIFICANT CONTROL WEAKNESSES						
4	CONTROL FINDINGS						

Report suspected fraud, or misuse of County resources by vendors, contractors, or County employees to 714.834.3608



INTERNAL AUDIT DEPARTMENT

Audit No. 1730

March 5, 2019

To: Thomas "Mat" Miller, Chief Real Estate Officer
County Executive Office/Real Estate

From: Scott Suzuki, CPA, Assistant Director *S Suzuki*
Internal Audit Department

Subject: Internal Control Audit: CEO/Real Estate –
Revenue Generating Lease Administration Process

We have completed an Internal Control Audit of the revenue generating lease administration process at CEO/Real Estate for the fiscal year ended April 30, 2018. Details of our results and recommendations immediately follow this letter. Additional information including background and our objectives, scope, and methodology are included in Appendix A.

CEO/Real Estate concurred with all of our recommendations and the Internal Audit Department considers CEO/Real Estate's management response appropriate to the recommendations in this report.

Results of this audit will be included in a future status report submitted quarterly to the Audit Oversight Committee (AOC) and the Board of Supervisors (Board). Additionally, we will request your department to complete a Customer Survey of Audit Services, which you will receive shortly after the distribution of our final report.

We appreciate the courtesy extended to us by CEO/Real Estate's personnel during our audit. If you have any questions regarding our audit, please contact me at 714.834.5509 or Senior Audit Manager Michael Dean at 714.834.4101.

Attachments

Other recipients of this report:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Frank Kim, County Executive Officer
- CEO/Real Estate Distribution
- Foreperson, Grand Jury
- Robin Stieler, Clerk of the Board of Supervisors
- Vavrinek, Trine, Day & Co., LLP, County External Auditor

INTERNAL AUDIT DEPARTMENT

RESULTS

BUSINESS PROCESS & INTERNAL CONTROL STRENGTHS	<p>Business process and internal control strengths noted during our audit include:</p> <ul style="list-style-type: none"> ✓ Duties over administration of revenue generating leases are adequately segregated. ✓ A manual system is in place to track each revenue generating lease that includes key dates, such as commencement and expiration dates. CEO/Real Estate is in the process of implementing an electronic system for tracking called Visual Lease. ✓ A contract file is maintained for each agreement and is updated regularly for proper documentation. This file includes rent amount changes and security deposit changes. ✓ Inspections are scheduled annually to ensure compliance with lease terms.
--	---

FINDING NO. 1	<p>Visual Lease</p> <p>CEO/Real Estate utilizes Excel spreadsheets to manually manage and track leases, but is in the process of implementing the Visual Lease software solution to assist in managing and tracking leases (only a portion of leases, approximately 30%, have been entered into the system).</p> <p>CEO/Real Estate plans to fully integrate Visual Lease by the end of 2019.</p>
CATEGORY	Control Finding
RISK	Using a manual process to manage and track leases increases the risk that rent, security deposit, or lease terms will not be updated appropriately, resulting in a loss of revenue.
RECOMMENDATION	We recommend that CEO/Real Estate prioritize the implementation of Visual Lease.
MANAGEMENT RESPONSE	Concur. CEO Real Estate is planning to fully integrate Visual Lease by the end of 2019.



INTERNAL AUDIT DEPARTMENT

FINDING NO. 2	Policy and Procedures
	A Standard Revenue Lease Form is used for all Revenue Generating Leases (RGLs). This form includes provisions such as rent, term, obligations, and requirements. The responsibilities of the County and applicable departments are stated throughout the form; however, CEO/Real Estate has not established written policy and procedures that clearly delineate its responsibilities for revenue generating lease contract administration versus applicable department responsibilities.
CATEGORY	Control Finding
RISK	Not having departmental policy and procedures could result in inconsistent administration of revenue generating leases (contracts) between CEO/Real Estate and the applicable department.
RECOMMENDATION	We recommend that CEO/Real Estate establish written policy and procedures that clearly delineate its responsibilities for revenue generating lease contract administration versus applicable department responsibilities.
MANAGEMENT RESPONSE	Concur. CEO Real Estate is planning to establish written policies and procedures to delineate its responsibilities for revenue generating lease contract administration by the end of 2019.

FINDING NO. 3	Revision of Rent and Security Deposit
	CEO/Real Estate sent memos late or did not send memos to tenants notifying them of rent and security deposit increases for five of 25 leases reviewed (20%).
CATEGORY	Control Finding
RISK	Not sending timely memos for increases in lease rent increases the risk that rent will not be revised timely, resulting in a loss of revenue. Additionally, not sending timely memos for increases in security deposit amounts increases the risk that the County might not be able to cover damages for excessive wear and tear, or other unmet conditions of the lease by the tenant.
RECOMMENDATION	We recommend CEO/Real Estate ensure rent and security deposit revision memos are sent to tenants timely.
MANAGEMENT RESPONSE	Concur. CEO Real Estate will ensure that rent and security deposit revision memos are sent to tenants timely, effective immediately.



INTERNAL AUDIT DEPARTMENT

FINDING NO. 4	Documentation of Supervisory Review	
	<p>The Leasing Team Manager reviews, but does not sign and date the inspection report before it is sent to the tenant.</p> <p>In addition, supervisory review is not documented on payment tracking reports for Fund 135 (Real Estate Development Program) lease payments.</p> <p>Supervisory review should be documented to ensure accountability is established for the reviews performed.</p>	
CATEGORY	Control Finding	
RISK	Not documenting supervisory review can increase the risk of undetected errors.	
RECOMMENDATION	We recommend that CEO/Real Estate ensure supervisory review is properly documented on applicable reports.	
MANAGEMENT RESPONSE	Concur. CEO Real Estate will ensure that supervisory review is properly documented, effective immediately.	
AUDIT TEAM	Michael Dean, CPA, CIA, CISA Zan Zaman, CPA, CIA Gianne Acosta, CIA	Senior Audit Manager Audit Manager I Audit Manager I



INTERNAL AUDIT DEPARTMENT

APPENDIX A: ADDITIONAL INFORMATION

OBJECTIVES	<p>Our audit objectives were to:</p> <ol style="list-style-type: none"> 1. Evaluate internal control over the revenue generating lease administration process to ensure CEO/Real Estate is providing adequate oversight over those leases. 2. Review revenue generating lease administration processes for efficiency.
SCOPE & METHODOLOGY	<p>Our audit scope was limited to internal control over revenue generating lease administration processes for the year ended April 30, 2018. Our methodology included inquiry, observation, examination of documentation, and testing of relevant transactions.</p>
EXCLUSIONS	<p>Our audit scope did not include a review of easements, licenses, permits, or leases not administered by CEO/Real Estate.</p>
PRIOR AUDIT COVERAGE	<p>We have not issued any audit reports for CEO/Real Estate with a similar scope within the last ten years.</p>
BACKGROUND	<p>CEO/Real Estate administers leases for several departments including: OCCR (including OC Parks), OCPW, SSA, and CEO. They also provide oversight on finalizing lease documents and collaborate with departments that report on lease provisions (e.g., payments).</p> <p>Board Resolution No. 14-014, Item No. 57 delegated authority to execute leases and licenses to CEO/Real Estate when the lease/license duration does not exceed ten years and the minimum monthly rental/license fee does not exceed \$10,000. Paragraph 3 states, "The Chief Real Estate Officer, County Executive Officer, or designee is authorized to determine fair market rent or license fee, establish criteria to determine tenant's/licensee's ability to pay, advertise the availability of property, select tenant or licensee, negotiate, amend and execute leases and licenses and related documents, upon review by County Counsel."</p>



INTERNAL AUDIT DEPARTMENT

PURPOSE & AUTHORITY	We performed this audit in accordance with the Annual Risk Assessment & Audit Plan for FY 2018-19 approved by the Audit Oversight Committee (AOC) and Board of Supervisors (Board).
PROFESSIONAL STANDARDS	Our audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing issued by the International Internal Audit Standards Board.
FOLLOW-UP PROCESS	<p>In accordance with professional standards, the Internal Audit Department has a process to follow-up on its recommendations. A first follow-up audit will generally begin six months after release of the initial report.</p> <p>The AOC and Board expect that audit recommendations will typically be implemented within six months or sooner for significant and higher risk issues. A second follow-up audit will generally begin six months after release of the first follow-up audit report, by which time all audit recommendations are expected to be implemented. Any audit recommendations not implemented after the second follow-up audit will be brought to the attention of the AOC at its next scheduled meeting.</p> <p>A Follow-Up Audit Report Form is attached and is required to be returned to the Internal Audit Department approximately six months from the date of this report in order to facilitate the follow-up audit process.</p>
MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL	In accordance with the Auditor-Controller's County Accounting Manual Section S-2 Internal Control Systems: "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls." Control systems shall be continuously evaluated by Management and weaknesses, when detected, must be promptly corrected. The criteria for evaluating internal controls is the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework. Our Internal Control Audit enhances and complements, but does not substitute for department management's continuing emphasis on control activities and monitoring of control risks.
INTERNAL CONTROL LIMITATIONS	Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to: resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in the department's operating procedures, accounting practices, and compliance with County policy.



INTERNAL AUDIT DEPARTMENT

APPENDIX B: REPORT ITEM CLASSIFICATIONS

Critical Control Weaknesses	Significant Control Weaknesses	Control Findings
<p>These are audit findings or a combination of audit findings that represent critical exceptions to the audit objective(s) and/or business goals. Such conditions may involve either actual or potential large dollar errors or be of such a nature as to compromise the department's or County's reputation for integrity. Management is expected to address Critical Control Weaknesses brought to its attention immediately.</p>	<p>These are audit findings or a combination of audit findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require prompt corrective actions.</p>	<p>These are audit findings concerning the effectiveness of internal control, compliance issues, or efficiency issues that require management's corrective action to implement or enhance processes and internal control. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.</p>



INTERNAL AUDIT DEPARTMENT

APPENDIX C: CEO/REAL ESTATE MANAGEMENT RESPONSE



County of Orange

County Executive Office

January 28, 2019

TO: Scott Suzuki, CPA
Acting Director
Internal Audit Department

**RE: Internal Audit: CEO Real Estate
Revenue Generating Lease Administration Process**

The Internal Audit Department completed a CEO Real Estate Revenue Generating Lease Administration Process Audit. Below are CEO Real Estate's responses to the Audit findings and recommendations.

Finding No. 1 – Visual Lease (Control Finding)

CEO Real Estate utilizes Excel spreadsheets to manually manage and track leases, but is in the process of implementing the Visual Lease software solution to assist in managing and tracking leases; however, only a small percentage of leases have been entered into the system (approximately 30% of the leases).

CEO Real Estate plans to fully integrate Visual Lease by the end of 2019.

Recommendation No. 1:

It is recommended that CEO Real Estate prioritize the implementation of Visual Lease

CEO Real Estate Management Response to Finding No. 1:

Concur. CEO Real Estate is planning to fully integrate Visual Lease by the end of 2019.

Finding No. 2 – Policies and Procedures (Control Finding)

A Standard Revenue Lease Form is used for all Revenue Generating Leases (RGLs). This form includes provisions such as rent, term, obligations, requirements, etc. The responsibilities of the County and applicable departments are stated throughout the form; however, CEO Real Estate has not established written policies and procedures that clearly delineate its responsibilities for revenue generating lease contract administration versus applicable department responsibilities.

Recommendation No. 2:

It is recommended that CEO Real Estate establish written policies and procedures that clearly delineate its responsibilities for revenue generating lease contract administration versus applicable department responsibilities.



INTERNAL AUDIT DEPARTMENT

CEO Real Estate Management Response to Finding No. 2:

Concur. CEO Real Estate is planning to establish written policies and procedures to delineate its responsibilities for revenue generating lease contract administration by the end of 2019.

Finding No. 3 – Revision of Rent and Security Deposit (Control Finding)

CEO/Real Estate sent memos late or did not send memos to tenants notifying them of rent and security deposit increases for five of 25 leases reviewed (20%).

Recommendation No. 3:

It is recommended that CEO Real Estate ensure that rent and security deposit revision memos are sent to tenants timely

CEO Real Estate Management Response to Finding No. 3:

Concur. CEO Real Estate will ensure that rent and security deposit revision memos are sent to tenants timely, effective immediately.

Finding No. 4 – Documentation of Supervisory Review (Control Finding)

The Leasing Team Manager reviews but does not sign and date the inspection report before it's sent to tenant. In addition, supervisory review is not documented on payment tracking reports for Fund 135 (Real Estate Development Program) lease payments. Supervisory review should be documented to ensure accountability is established for the reviews performed.

Recommendation No. 4:

It is recommended that CEO Real Estate ensure that supervisory review is properly documented on applicable reports.

CEO Real Estate Management Response to Finding No. 4:

Concur. CEO Real Estate will ensure that supervisory review is properly documented, effective immediately.

Sincerely,

Thomas A. Miller
Chief Real Estate Officer
County Executive Office