County of Ventura
AUDITOR-CONTROLLER
MEMORANDUM

To: Paul Grossgold, Director, General Services Agency **Date:** March 9, 2007

From: Christine L. Cohen

Subject: AUDIT OF GENERAL SERVICES AGENCY (GSA) LEASE/OPERATOR AGREEMENT ADMINISTRATION

EXECUTIVE SUMMARY

We have completed our audit of GSA lease/operator agreement administration ("lease administration"). Our overall audit objective was to determine whether GSA's lease administration efforts effectively and efficiently maximized revenues and minimized risks to the County. Specifically, we evaluated GSA's policies and procedures related to: capital improvement monitoring; contract life-cycle management; controls over collection of monies due; lessee insurance coverage evaluations; and financial reporting and record keeping requirements. Our audit focused on lease administration for Kenney Grove, Oak Park, and Steckel Park (also known as Far West) campgrounds, and Rustic Canyon, Saticoy, and Soule Park golf courses. The audit was performed in accordance with the *International Standards for the Professional Practice of Internal Auditing* promulgated by the Institute of Internal Auditors. Our findings are summarized below with details provided in the attached.

During our audit, we noted that GSA took certain measures to maximize revenues and minimize risks related to lease administration. For example, we recognize GSA for implementing procedures to ensure that all lease revenues will be confirmed on a 2-year cycle by external accounting firms. We also noted certain improvements in contract management and capital improvement monitoring over the past year.

However, overall, we found that some significant liability risks have been present over the past several years and that many of these risks still remain. We also identified specific instances where at least $8,440 in revenues were available, but not collected. Specifically, during our audit, we noted that lease administration could be improved by:

- Dedicating specific and sufficient resources to lease administration.
- Strengthening oversight of lessee compliance with capital improvement requirements.
- Enhancing controls over contract life-cycle monitoring.
- Improving management of the collection of monies due.
- Monitoring lessee compliance with insurance requirements more closely.
- Reviewing lessee accounting systems on a more timely basis.

GSA management initiated corrective action to address our audit findings. Corrective action is planned to be completed by June 30, 2007.

We appreciate the cooperation and assistance extended by you and your staff during this audit.

Attachments

cc: Honorable Linda Parks, Chair, Board of Supervisors
Honorable Steve Bennett, Board of Supervisors
Honorable Kathy Long, Board of Supervisors
Honorable Peter Foy, Board of Supervisors
Honorable John K. Flynn, Board of Supervisors
John F. Johnston, County Executive Officer

AUDIT OF GENERAL SERVICES AGENCY (GSA) LEASE/OPERATOR AGREEMENT ADMINISTRATION

BACKGROUND:

GSA contracts with private parties to manage Kenney Grove, Oak Park, and Steckel Park (also known as Far West) campgrounds under long-term lease agreements. The management of Rustic Canyon and Saticoy golf courses are also contracted under long-term leases. The general terms of the lease agreements require that the lessees invest specific dollar amounts in capital improvements and pay the County base rent and a percentage of gross receipts. GSA budgeted total revenue from these lease agreements of approximately $386,100 at the beginning of fiscal year 2005-06, and recognized revenue of approximately $345,400 (89%) by fiscal year-end.

Soule Park Golf Course is currently managed under a short-term operator agreement that expires in March 2007. Under this agreement, the County pays for capital improvements and pays the operator a management fee. In return, the operator pays the County 100 percent of net operating income. At the beginning of fiscal year 2005-06, GSA anticipated that revenues would exceed expenditures for Soule Park by nearly $638,700. However, because of delays in constructing a fully operational golf course, revenue fell short of goals, resulting in $385,740 in operating losses for Soule Park.

GSA lease/operator agreement administration ("lease administration") was historically handled by the GSA Parks Department ("Parks"). Although Parks continues to manage operational aspects of lease administration, fiscal responsibilities shifted to GSA Fiscal Services ("Fiscal") in August 2005.

SCOPE:

Our overall audit objective was to determine whether GSA's lease administration efforts effectively and efficiently maximized revenues and minimized risks to the County. Specifically, we evaluated GSA's policies and procedures related to: capital improvement monitoring; contract life-cycle management; controls over collection of monies due; lessee insurance coverage evaluations; and financial reporting and record keeping requirements. Our audit focused on lease administration for Kenney Grove, Oak Park, and Steckel Park campgrounds, and Rustic Canyon, Saticoy, and Soule Park golf courses. The audit was performed in accordance with the *International Standards for the Professional Practice of Internal Auditing* promulgated by the Institute of Internal Auditors.

Because of the breadth and variety of lease terms and provisions, the time periods reviewed for each audit objective varied depending on circumstances. For capital improvement monitoring, we evaluated compliance with lease requirements from the inception of each lease through August 2006. For contract life-cycle management, we assessed: the completeness of lease files from the inception of each lease; the procedures for monitoring contract life-cycles from the time Fiscal assumed lease administration in August 2005; and the propriety of the latest base rent and percentage rent adjustments. For controls over collection of monies due, we evaluated: late fees, fines, and penalties from July 2005 through August 2006; base rents and security deposits since the last rent adjustment date; and applicable percentage rents for calendar year 2005, except that our evaluation of the Saticoy lease was expanded to 2001 through 2005. For insurance coverage evaluations, we compared the current certificates of coverage with individual lease requirements and County Risk Management requirements. For financial reporting and record keeping requirements, we evaluated lessee financial reporting for calendar year 2005 and applicable record keeping requirements throughout each lease term.

FINDINGS:

We found that Fiscal improved lease administration since becoming involved in August 2005. Notably, Fiscal created a revenue exam schedule to ensure that all lease revenues are reviewed on a 2-year cycle by external accounting firms. We also noted that certain aspects of lease administration were tracked electronically to improve contract management and that capital improvement projects were monitored more closely. Further, we noted that Fiscal improved communication with lessees to foster better working relationships and that Fiscal initiated corrective action immediately in several problem areas discovered during this audit.

However, overall, our audit disclosed that further improvements were needed to strengthen lease administration, which could benefit from GSA dedicating specific and sufficient resources to manage the lease administration function. Specifically, we found that oversight of capital improvements was in need of improvement to mitigate the risk to the County from property degradation, and possible code compliance and environmental hazard liability. We also noted weaknesses in contract life-cycle monitoring and controls over collections, resulting in uncollected revenues of $2,345 in late fees, $3,412 in percentage rent, and $2,682 in security deposit increases. In addition, we noted that improvements were needed to properly monitor lessee insurance requirements and ensure that lessee systems of accounts and records were properly reviewed.

Summarized below are details of the areas where improvements were needed. Management initiated corrective action during the audit as noted in GSA's written response, which is included as an exhibit to this report.

1. Lease Administration Resources. Although we noted that Fiscal initiated certain improvements since August 2005, we believe that lease administration could be further strengthened by dedicating sufficient resources to the lease administration function. Staff turnover, outdated policies and procedures, miscommunication, inadequate training, and piecemeal administration have contributed to errors and lapses in lease administration as described in the findings below. We recognize that, prior to our audit, GSA acknowledged certain weaknesses in the lease administration function, prompting actions to consider lease administration software as an option to strengthen controls. We encourage GSA to continue the pursuit of such options. We believe that committing specific resources, such as hiring a dedicated lease administrator or purchasing lease administration software, could streamline the administration process and help to eliminate the weaknesses noted during our audit.

2. Capital Improvements. GSA's oversight of capital improvements required by lessees was not always sufficient to properly monitor, verify, and document compliance. Each lease agreement required specific capital improvements to be completed by specific deadlines. However, the lease files did not always contain evidence that capital improvement requirements were met, nor could GSA affirm that all required capital improvements were completed. A significant County benefit from these lease agreements is that capital improvements are made to County property at the lessees' expense. Not verifying lessee compliance with capital improvements potentially nullifies that benefit, creates a risk of asset degradation, and potentially exposes the County to liability if improvements are not completed in accordance with code requirements.

A. Follow-up on Non-Compliance. GSA did not always adequately resolve known instances of lessee non-compliance regarding capital improvements in a timely manner. As a result, significant lease violations sometimes continued over many years. For example, a 1999 inspection of capital improvements completed by the Steckel Park lessee since 1994 disclosed several permit violations. Although 11 improvements needing permits were noted in the original inspection report, only 2 permits were later obtained. Over the course of the past 7 years, at least four letters from GSA to the lessee requested compliance and proof of permits; however, such actions apparently failed to illicit corrective action from the lessee. Because these improvements included potential environmental hazards (e.g., septic system, seepage pit, and sewer connections), the County remains at risk of incurring significant costs for removal or modification.

B. Inspections. Periodic inspections were not consistently performed and documented to verify lessee compliance with capital improvement obligations. Specifically, the lease files did not contain evidence that Oak Park, Rustic Canyon, Saticoy, or Steckel Park lessees had satisfied all capital improvement requirements. In addition, GSA's inspection of Kenney Grove did not occur until 12 years after the capital improvements were required to be invested. Therefore, GSA did not have adequate assurance that all capital improvements were completed or acceptable. For example, a January 2006 inspection report disclosed that restroom buildings at Steckel Park did not meet the federal Americans with Disabilities Act (ADA) accessibility requirements. As a result, the County was at risk of sustaining significant ADA penalties for non-compliance. Routine inspections would have noted the improvements being made, and the questionable nature of the work could have been addressed in a more timely manner.

C. Receipt Reconciliation. Tenant-reported capital improvement expenses were not always reconciled with receipt documentation from actual work completed in a timely manner. Four of the six lease agreements required the lessees to submit receipt documentation for specific capital improvements and/or for specific dollar amounts spent on capital improvements. However, adequate receipt verification was not found in the lease files for over $180,000 in Saticoy expenditures that were due in 1988. Also, although the Steckel Park lease required that $100,000 in capital improvements be completed by 1995, GSA did not verify the expenditures until 4 years later in 1999. Further, although the Kenney Grove lessee was not required to submit documentation for $100,000 in capital improvements required the first year, the contract did allow GSA to audit the lessee's records. However, GSA did not confirm the lessee's capital improvement expenditures until 12 years later. Timely reconciliation of receipt documentation is essential for GSA to verify compliance with lease terms.

D. Lease Assignment. GSA imprudently allowed a lease assignment although significant capital improvement violations were present. Specifically, the Steckel Park lease was assigned from Far West Resorts, Inc., to Far West Resorts LLC, in March 2000. The assignment approval letter required that the leasehold premises be brought into full compliance within 12 months, and we did not note any contract provisions prohibiting assignment due to capital improvement non-compliance. However, approving a lease assignment when such significant deficiencies were apparent reduces the County's leverage for remediation.

E. Fines/Penalties for Non-Compliance. GSA did not assess damages to lessees that did not comply with capital improvement requirements, as allowed by lease terms. Under the liquidated damages clause in the Kenney Grove, Rustic Canyon, Saticoy, and Steckel Park leases, fines accrue daily to encourage the lessee to correct the violation quickly. However, damages were not assessed to any of the lessees, although to what extent damages should have been assessed or to which lessees could not be determined because of lapses in GSA inspections and documentation. Not assessing damages inadvertently contributes to an environment for non-compliance, which can lead to potentially serious consequences, as experienced with Steckel Park as described above.

3. Contract Life-Cycle Monitoring. Policies and procedures related to contract life-cycle monitoring were not always clear or consistently followed to facilitate proper tracking of contract milestones. As a result, we found that controls were not always sufficient to identify delinquent payments, late fees, and rent adjustment dates. This condition was further aggravated by incomplete lease file documentation and unclear lease contract language.

   A. Delinquent Payments and Late Fees. Controls used to flag delinquent payments and late fees were not always adequate. For example, the Saticoy lessee failed to pay a total of $13,520 for January and February 2006 base rent and applicable rent increases until March 2006, when late fees were finally invoiced. As a contributing factor, each successive invoice from January through March did not include line items for the unpaid amounts, which may have alerted the lessee to the discrepancy earlier. Without proper controls and procedures to identify and follow-up on late payments and penalties, collection of lease payments may become impaired.

   B. Tracking Sheets. Core data was not always entered correctly on electronic tracking sheets used by GSA to monitor key lease data. For example, one of seven errors found on the minimum annual rent, percentage rent, and security deposit tracking sheet flagged Rustic Canyon's percentage rent update for July 2007; however, the update is not due until May 2011. As a result of such errors on several different tracking sheets, the County could become exposed to unnecessary insurance risks and over/under collected monies due.

   C. Lease Files. Lease files did not always contain appropriate support documents. For example, a file containing significant correspondence documents was recently found in the former Parks Department Manager's office; however, Fiscal was not aware that the file existed. Management acknowledged the possibility that not all file information was transferred from Parks when Fiscal assumed lease administration. Therefore, a full file review may be necessary to establish accountability over lease events from origin to current status.

   D. Contract Language. Lease contract language was not always clear, sometimes resulting in misinterpretation and misapplication of lease provisions. For example, problems relating to tracking rent updates mentioned above may have been avoided if lease contracts referenced specific dates rather than general terms. During our audit, we found that such general terms as "at the beginning of the eleventh year and of each five-year period thereafter" found in the Kenney Grove lease contributed to rent tracking errors. In addition, other lease provisions appeared to be contradictory, which could weaken the County's position should litigation become necessary. Specifically, we noted that, although the Steckel Park lease allowed for liquidated damages in the capital improvement clause, the liquidated damages clause referenced other specific contract provisions, but not capital improvements.

4. Collection of Monies Due. Controls over the collection of monies due were not always adequate. As a result, we found lapses in assessing late fees and in properly calculating percentage rents and adjusting base rents.

   A. Assessment of Late Fees. Fines and penalties for late payments were not always assessed. Specifically, we noted that late fees totaling $2,345, plus applicable interest, were available, but not charged to several lessees from July 2005 through August 2006. Because we found that some late fees had been charged, such inconsistent practices can create an appearance of favoritism and does not foster a sense of urgency regarding timely payments from lessees.

   B. Accuracy of Percentage Rents. Percentage rents were not always calculated correctly. Specifically, the Saticoy lessee underpaid percentage rent by $3,412 for 2004 through 2005 because the lessee based percentage rents on annual rather than quarterly revenues. (Note: During the audit, GSA verified the discrepancy and initiated corrective action to identify and collect unpaid percentage rents. For example, GSA advised the Saticoy lessee and the accounting firm scheduled to conduct the Saticoy lease revenue exam of the proper calculation methodology.)

   C. Accuracy of Base Rent Adjustments. Base rents were not always adjusted correctly, resulting in potentially incorrect rent payments and security deposits. Specifically, we found that the Saticoy lessee's base rent was adjusted to $6,925 per month in February 2006; however, the correct base rent should have been $7,372 per month. As a result, the lessee's security deposit was also $2,682 short of the one-half of the minimum annual rent required. The discrepancy resulted from inconsistent application of excess replacement deposit reserve funds and incorrect percentage rent calculations. Although the lessee did not owe the difference of $447 per month because percentage rents exceeded base rents for the period, oversight needed to be strengthened to ensure proper adjustments. (Note: During the audit, GSA verified the discrepancy and notified the lessee of the correct base rent and security deposit amounts.)

   D. Timeliness of Base Rent Adjustments. Base rents were not always adjusted in a timely manner. Specifically, the Rustic Canyon lessee's base rent should have been adjusted effective May 1, 2006; however, GSA did not schedule the adjustment until July 1, 2007, due to a misinterpretation of a later agreement added to the lease. GSA stated that waiting to adjust the base rent would likely result in increased revenues to the County because the adjustment would be based on a higher dollar volume of prior rent paid. However, regardless of immediate revenue benefits to the County, we believe that rent adjustments need to occur according to the lease terms.

5. Insurance Coverage. Lessee compliance with insurance requirements was not always monitored adequately. Each lease agreement required various types and levels of insurance coverage, specifically based on each property. However, we found that GSA did not always follow-up with non-compliant lessees and verify insurance coverage to lease requirements, thereby increasing financial liability risks to the County.

   A. Renewal Certificates. Although courtesy notices were sent to lessees as a reminder to submit evidence of renewed insurance coverage, follow-up did not always continue until the renewal certificate was received. For example, a reminder notice was sent to the Rustic Canyon lessee 30 days before the Workers' Compensation insurance expired. However, the lessee did not submit the renewal certificate by the expiration date, nor was follow-up initiated, until the auditor requested a copy of the renewal. Without evidence of current insurance coverage by lessees, the County could be at risk of unnecessary exposure to liability.

B. Coverage Compliance. Specific insurance requirements mandated by the lease contracts were not always confirmed or documented upon receipt of the insurance certificates. For example, although the Soule Park operator agreement required $100,000 in Food Service Liability Insurance, the coverage was not listed on the insurance certificate. Also, the Rustic Canyon lessee was required to maintain Business Interruption Insurance equal to 100 percent of gross income for a 6-month period. However, while evidence of coverage was listed on the insurance certificate and GSA management claimed to have reviewed the sufficiency of the coverage amount, such reviews were not documented. Although complete coverage was confirmed based on our inquiries, documented verification of coverage is necessary upon initial receipt of insurance certificates to mitigate liability risk to the County.

6. Accounting Systems. Information relating to lessee systems of accounts and records was not submitted for approval to the Auditor-Controller's Office at the commencement of the lease as required by four lease contracts. Although the accounting systems were eventually reviewed by GSA, the reviews disclosed accounting system issues that may have been avoided. For example, accounting problems were discovered during two lease reviews of Steckel Park that inhibited the reviewer's ability to perform revenue testing. Such problems may have been discovered more timely had the system of accounts and records been reviewed at the beginning of the lease as required.

MANAGEMENT ACTION: GSA management concurred with the audit findings and indicated that procedures have been implemented to strengthen lease administration. Due to the general nature of GSA's response, we have included the document as an exhibit to this report.

AUDITOR'S EVALUATION OF MANAGEMENT ACTION: We believe that management actions taken or planned were responsive to the audit findings. Management planned to complete corrective actions by June 30, 2007.

We appreciate the cooperation and assistance extended by you and your staff during this audit.

Paul S. Grossgold
Director

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DATE: March 1, 2007

TO: Christine L. Cohen
Auditor-Controller

FROM: Paul Grossgold
Director

SUBJECT: AUDIT OF GENERAL SERVICES AGENCY (GSA) LEASE/OPERATOR AGREEMENT ADMINISTRATION

This memorandum is in response to the Lease/Operator audit of the General Services Agency (GSA) Parks Department conducted by your office. GSA concurs with the overall audit findings as they relate to the opportunities for improvements to strengthen oversight of the Park leases. It should be noted, however, that many of the weaknesses identified were from years past or are longstanding issues (Steckel Park/Far West Resorts) that GSA has been aggressively working to remedy.

Specifically, during the audit, it was noted that lease administration could be improved by:

- Dedicating specific and sufficient resources to lease administration
- Strengthening oversight of lessee compliance with capital improvement requirements
- Enhancing controls over contract life-cycle monitoring
- Improving management of the collection of monies due
- Monitoring lessee compliance with insurance requirements more closely
- Reviewing lessee accounting systems on a more timely basis

The following information includes actions taken and those that are proposed in response to the audit.

As indicated by the auditor, the fiscal component of lease administration was transferred to Administrative Services (AS) effective August 2005 and oversight of leased parks' operations continued under the Parks manager. This transfer of responsibility was as a result of deficiencies in record keeping that were identified by the AS Fiscal Division during a special project performed to update lease file "Lease Summary "sheets. Lessees were notified by U.S. mail of the change in "Notice and Payments" provision of the lease in July 2005. The Fiscal Manager was named as the point of contact for questions regarding lease required notices and payments. The consolidation was in keeping with the agency-wide goal to centralize fiscal functions under one department.

Recognizing the need to improve the lease management function, but not having the staffing resources to dedicate to the process, the Fiscal Manager engaged an outside accounting firm to conduct lease audits on a regular schedule. The Fiscal Manager also identified lease contract management software to purchase. However, in April 2006, your office announced that a lease audit would be conducted and the purchase of software was suspended pending the results of the audit.

With the audit now complete, the software purchase process has been initiated. The software being contemplated will strengthen and improve lease management and address most of the fiscal and contract compliance weaknesses noted in the audit. Once the database is established, the software will track key dates, milestones, obligations and requirements and provide easy access to information. All original final lease documents will be centrally stored in the Administrative Services location and working files will be maintained by the Parks.

Additionally, in June 2006, GSA was successful in reestablishing the dedicated Deputy Director of Parks position as a part of its management team. This position provides the Parks with greater hands on management and accountability. The Deputy Director has reinstituted a regular program of site inspection of leased facilities, including annual verification of capital improvements and repairs.

We look forward to strengthening financial controls through the implementation of the contract management tracking system, maintaining a regular schedule with the outside audit firm, and improving operational oversight with regular park inspections. Toward that end, we appreciate any assistance that your office can provide in assuring that these goals are met.

Please contact me at 654-3800 or Rebecca Arnold at 648-9205 if you wish to discuss the audit or response further.

c: Rebecca Arnold, Deputy Director, Administrative Services
Greg Bergman, Fiscal Manager