

# **FOLLOW-UP REPORT**

## **Division of Real Estate**

### ***Revenue Leases***

#### **December 2018**

**Office of the Auditor  
Audit Services Division  
City and County of Denver**



**Timothy M. O'Brien, CPA  
Denver Auditor**



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December 27, 2018

## AUDITOR'S REPORT

In keeping with generally accepted government auditing standards and the Audit Services Division's policy, as authorized by D.R.M.C. § 20-276, our division has a responsibility to monitor and follow up on audit recommendations to ensure audit findings are being addressed through appropriate corrective action and to aid us in planning future audits.

Our follow-up effort for the Division of Real Estate Revenue Leases audit issued July 20, 2017 determined the Division of Real Estate has not fully implemented some of the recommendations made in the audit report. Of the six recommendations offered to the Division of Real Estate, one was implemented, two were partially implemented, and three were not implemented. Auditors therefore determined the risk associated with the audit team's initial findings has not been fully mitigated. Audit Services may revisit these risk areas in future audits to ensure appropriate corrective action is taken.

For your reference, this report includes a highlights page that provides background and summary information on the original audit and the completed follow-up effort. Following the highlights page is a detailed implementation status update for each recommendation.

This concludes audit follow-up work related to this audit. I would like to express our sincere appreciation to you and to the Division of Real Estate personnel who assisted us throughout the audit and follow-up process. If you have any questions, please feel free to contact me at 720-913-5000 or Jeremy Creamean, Internal Audit Supervisor, at 720-913-5028.

Denver Auditor's Office

A handwritten signature in black ink, appearing to read "Timothy M. O'Brien".

Timothy M. O'Brien, CPA  
Auditor



## Revenue Leases December 2018

### Follow-up Status

The Division of Real Estate implemented one recommendation, partially implemented two recommendations and did not implement three recommendations made in the July 2017 audit report.

### Objective

The objective of the audit was to examine Real Estate's monitoring of City-owned property leases. The audit evaluated the monitoring of lease agreements to ensure that revenue was received and lessees were held accountable for compliance with lease terms. We also evaluated whether there was proper justification and documentation for below-market and nominal leases granted to business organizations.

### Background

The Division of Real Estate manages the City's real estate portfolio. Responsibilities include conducting administrative tasks, providing oversight, and monitoring compliance with lease terms, as well as managing the amendment and termination processes.

## REPORT HIGHLIGHTS

### Highlights from Original Audit

Although lessees generally complied with lease terms, we found that key internal controls were lacking in several areas, resulting in lessee payment and reporting deficiencies going undetected. Specifically, we identified issues in the following areas:

- Lack of lease payment reconciliations
- Missing payments, late payments, and payments remitted in incorrect amounts
- Checks mailed to wrong addresses
- Accounting entries lacked basic information on payee

We also found that lease reporting requirements were not tracked or monitored. Further, certificates of insurance were not properly tracked or monitored. Finally, the criteria and business case for renting at nominal rates to certain business organizations was not properly documented.

Through development of stronger policies and procedures, the Division of Real Estate would be better positioned to ensure effective oversight, holding lessees accountable for compliance with all lease terms. Our report provided six related recommendations.

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## RECOMMENDATION STATUS OF IMPLEMENTATION

**FINDING:** The Division of Real Estate's Limited Controls over Lease Management Has Resulted in Uncollected Payments and Non-Compliance.

### Recommendation

- 1.1 **Payment Receipts and Reconciliations** – The Division of Real Estate's policies and procedures should be more clearly defined to ensure periodic reconciliations of rent and other payments (e.g. utilities, percentage of gross sales, etc.) due to the City from lease contracts. These reconciliations should be completed quarterly or more frequently if prescribed by lease terms. The procedures should address the following elements;
- Key terms to be reconciled
  - Frequency of reconciliations
  - Dates for completing and reviewing reconciliations and responsible parties
  - Reconciliations records maintenance and retention

In addition, payment term calculations should be reviewed for accuracy for each new or amended lease.

**Status: Partially Implemented – Original implementation date – October 2017**

### Agency Action

The Division of Real Estate developed lease policies and procedures to address the need to perform periodic reconciliations of rent and other payments, the frequency of such reconciliations, dates for completing and reviewing reconciliations as well as responsible parties. The policies and procedures also addressed maintenance and retention of such reconciliations. In order to implement the new policy, the Division of Real Estate created a lease log to help track these critical lease elements. However, the log did not note due dates for reconciliations or responsible parties. In addition, the log only included leases administered by the Division of Real Estate and excluded many leases administered by other agencies, despite the Division of Real Estate's mission being to oversee the entire City real estate portfolio. Finally, we reviewed one reconciliation, noting that it was only completed annually instead of quarterly as prescribed by the recommendation. While the policies and procedures were adequately written in accordance with the recommendation, the successful implementation of the defined procedures is incomplete.

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### Recommendation

- 1.2 **Accounting Entry Descriptions** – The Director of the Division of Real Estate should work with the Controller's Office to develop a procedure that requires accounting entries to be standardized to ensure that the lessee's legal name and the period the payment covers are included in the description. This policy should be used until the accounts receivable module is available in Workday and it is our recommendation that the Division of Real Estate utilize the accounts receivable module that will allow for payment identification with the use of unique identifiers for each lessee.

**Status: Not Implemented – Original implementation date – October 2017**

**Agency Action**

The Division of Real Estate’s lease policies and procedures did not address the standardization of accounting entries for lease payments. Based on a review of cash receipt entries in the system of record (Workday), the entries for one lessee varied from entry to entry. This practice adds to the difficulty of reviewing these transactions. In addition, the accounts receivable module is not yet available for use in Workday which may be able to assist with standardizing the accounting entries.

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**Recommendation**

- 1.3 **Check Handling** – The Director of the Division of Real Estate should create a check handling policy and procedure to account for all checks received from lessees. The procedure should include a method to log checks and guidance to alert the lessee when timely payment is not received. When possible, Real Estate should encourage lessees to use the City’s on-line payment system to mitigate risk of loss associated with manual checks.

**Status: Implemented**

**Agency Action**

The Division of Real Estate created a check-handling policy and procedure that includes logging checks received to be reviewed for accuracy and guidance on alerting lessees when timely payment is not received. The policy also requires the division to inform lessees about using the City’s online payment system. We reviewed documentation showing that the division is using the check log for leases it administers.

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**Recommendation**

- 1.4 **Monitoring Reporting Requirements** – The Director of the Division of Real Estate should develop policies and procedures to track and ensure that all reporting requirements stated in leases are met, centralizing the responsibility in the Division of Real Estate. A lease abstract with all requirements listed should be completed and kept up-to-date for each lease and subsequent amendments, incorporating any lease escalation payment schedules and term changes. The abstract will provide an effective tool to monitor key terms in the lease and aid in reconciliation of payments.

**Status: Not Implemented – Original implementation date – October 2017**

**Agency Action**

The Division of Real Estate created policies and procedures to track and ensure reporting requirements stated in leases are achieved. However, we were unable to obtain evidence to support the implementation of these policies. Division of Real Estate personnel asserted that they monitored key lease reporting terms through the “real estate rent receipt log,” but the log we received only shows that rent payments were received and does not provide any evidence that required reports are being submitted by the lessee. Furthermore, we noted that the policy did not explicitly centralize responsibility in the Division of Real Estate.

The Division of Real Estate did provide an example of a lease abstract created for a new 2018 lease, evidencing that the recommendation for completing and updating lease abstracts has been

implemented. However, the core risk related to monitoring reporting requirements has not been adequately addressed.

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**Recommendation**

- 1.5 **Certificates of Insurance** – The Division of Real Estate should ensure that current Certificates of Insurance are on file and monitored to ensure that they comply with all key terms of the lease. The Division of Real Estate’s policies and procedures should be developed to review, track, and verify each required insurance element annually for each lease.

**Status: Not Implemented – Original implementation date – October 2017**

**Agency Action**

The Division of Real Estate implemented new policies and procedures related to ensuring certificates of insurance are on file. The policy states that for each lease the expiration date will be logged and reviewed monthly. However, the policy and the log is silent on which insurance elements should be verified for each lease during the review. In addition, the policy indicates that tenants will be notified if a new certificate of insurance is required. Our review of certificates of insurance on file found that about 94 percent of leases had a current certificate of insurance as of September 10, 2018. We also noted that the lease log includes information related to the expiration date of the current certificate of insurance. Because not all leases on file had a certificate of insurance, the risk identified in the audit was not adequately addressed, and the recommendation was not fully implemented.

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**Recommendation**

- 1.6 **Below-Market and Nominal Leases** – The Director of the Division of Real Estate should ensure that documentation for renting City real property at below-market rates or nominal rates to business organizations follow relevant criteria that establish a business case for such an agreement.

**Status: Partially Implemented – Original implementation date – September 2017**

**Agency Action**

The Division of Real Estate developed new policies and procedures requiring it to obtain and maintain support for the tenant’s qualifications for nominal leases. However, the policy did not identify any relevant criteria for the Division of Real Estate to follow. In testing implementation of the policy, we were able to obtain appropriate support five out of six of the criteria cited in executive order 100 for the nominal lease. While the policies and procedures were written in accordance with the recommendation, the successful implementation of the defined procedures is incomplete.

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## CONCLUSION

The Division of Real Estate has only implemented one recommendation made in the Revenue Leases Audit Report. Three recommendations have yet to be adequately acted upon and two have not been fully implemented. Therefore, we determined the risk associated with the audit team's initial findings has not been fully mitigated. As a result, the Audit Services Division may revisit these risk areas in future audits to ensure appropriate corrective action is taken.

On behalf of the citizens of the City and County of Denver, we thank staff and leadership from the Division of Real Estate for their cooperation during our follow-up effort and their dedicated public service.

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## Office of the Auditor

The **Auditor** of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies and contractors for the purpose of ensuring the proper and efficient use of City resources. He also provides other audit services and information to City Council, the Mayor, and the public to improve all aspects of Denver's government.

The **Audit Committee** is chaired by the Auditor and consists of seven members. The Audit Committee assists the Auditor in his oversight responsibilities regarding the integrity of the City's finances and operations, including the reliability of the City's financial statements. The Audit Committee is structured in a manner that ensures the independent oversight of City operations, thereby enhancing citizen confidence and avoiding any appearance of a conflict of interest.



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We deliver independent, transparent, and professional oversight in order to safeguard and improve the public's investment in the City of Denver. Our work is performed on behalf of everyone who cares about the City, including its residents, workers, and decision-makers.

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