

Findings and Recommendations

1. Incomplete Accountability over Rent Collection

The department does not have adequate controls over rent collection.

Acquisition administers Port's relocation programs for affected homes and businesses in neighboring communities of the airport. In doing so, the department becomes an *incidental* landlord of the acquired property until the property is vacated through relocation. In transition, the department enters into a lease agreement whereby the tenant agrees to a rent with generally expected lease provisions (e.g., late payment penalty etc.). The actual rent income for the period under audit was approximately \$1.2 million.

Controls necessary to provide reasonable assurance and accountability over rent collection included, but are not limited to, policies and procedures to establish a baseline expectation as to how much and how often rent revenue is expected. The baseline is followed up with adequate management monitoring including independent reconciliation between expected rent and collection rent. The auditor noted that management monitoring controls were either absent or cursory in nature. As a result, for the period under audit, all expected rent income cannot be completely accounted for with available written documentation.

The auditor noted a number of exceptions as follows:

- The department has no billing system for over 277 non-business accounts. Rent for those customers was largely on a self-reporting basis.

Management Response: The certified rent roll (which reflected the expected rent revenue at the time the property was purchased) was prepared for both Tyee and Town and Country by outside legal counsel prior to purchasing the property. This was considered the expected rent income receipt starting point. As tenants moved out of the park, expected rent receipts on the rent roll were reduced until all tenants had moved from a particular property.

- Rent analysis and/or expectations from those non-business accounts were not adequately monitored. Consequently, management was not able to assess whether received rent was complete in relation to what should have been collected.

Management Response: When ownership of the parks was transferred to the Port, the rent roll provided at property closing reflected the baseline billing. This document was used for subsequent monthly rent reconciliations. Tenants paid per their rent according to signed lease agreement. No monthly billing or statement was sent to the tenant. This represented a typical residential leasing operation; there was no automated residential billing system. Rent expectations were monitored monthly by Port staff via the monthly report provided by the either the property management consultant (via email) or the internal daily rent roll activity report.

- The terms of the lease agreement were not consistently and completely enforced. Certain rents and penalties were not assessed or collected; they were said to have been forgiven. However, the auditor could not find supporting documentation to substantiate that fact.

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- In a test sample of 10 late rent payments, 6 payments were not assessed penalty that totaled \$150.
 - The final settlement at closing/move-out is design to remedy all outstanding amounts owed to the Port, but the auditor noted numerous instances where such settlements did not occur. In a test sample of 21 rented units, we noted ~\$13,000 and ~\$1,500 in uncollected back rents and penalty, respectively.

Management Response: Due to financial challenges (extremely low incomes) and circumstances of the tenants prior to 2008, Port staff adopted a more lenient rent collection stance. Port Acquisition and Relocation staff uniformly forgave the rent for any partial month of occupancy as an additional relocation benefit and incentive for the tenant to move in a timely manner. In late 2008, an increase in the number of financially stable tenants allowed the department to recover the uncollected rent revenue when the unit was sold to the Port. In essence, owed rent is treated as a line item deduction payable to the Port at escrow closing.

Acquisition and Relocation activities are regulated by federal law, the Uniform Relocation Assistance Act of 1970, 49CFR, Part 24.207(f) an Agency (the Port) may deduct from relocation payments any rent that the displaced person owes the Agency; provided that no deduction shall be made if it would prevent the displaced person from obtaining a comparable replacement dwelling as required under relocation provisions...”

Eviction is contrary to the department’s mission, a violation of federal law and would jeopardize federal funding.

- In a test sample of 25 properties, we noted that 13 (52%) lease agreements were either not signed or were signed *after* acquisition was completed.

Management Response: Per Port legal staff recommendation, Port Acquisition and Relocation staff were advised not to contact the tenants of a property the Port did not yet own, prohibiting staff and consultants from presenting and obtaining executed lease agreements prior to the property’s transfer to the Port. This fostered collaborative, productive and positive negotiations with the property owner and reduced or prevented potential claims by the park owner for lost revenue due to the tenants moving because of the Port’s actions. Timing of the actual acquisition was subject to many variables and presenting leases to property tenants was appropriate only after negotiations with the property owner had reached a settlement. Every effort was made to obtain signed leases from each tenant. Unfortunately, tenants were often uncooperative and refused to sign any lease presented to them by the Port.

The department appears to have viewed the rent as an ancillary, rather than an equally important part among many functions of the overall relocation program. Consequently due diligence, including management monitoring, exercised on rent collection was less than would be expected in order to properly collect all expected rent income.

Management Response: Acquisition & Relocation Department Staff efforts to collect must be viewed within the framework of the department’s mission: To acquire noise impacted property, to relocate persons, and to clear that property for public use under eminent

domain. Aviation Property Acquisition Department is the only department within the Port of Seattle that facilitates Eminent Domain real estate takings under provisions of the Federal Uniform Relocation Act of 1970 (URA).

Uncollected rents and fees represent a loss of public financial resources without any feasible means of recovery. If not addressed, the observed control inadequacies will continue to materialize in financial losses, and the department's struggle over accountability of rent revenue will likely continue.

Management Response: We collected rents as we were able and tailored our collection efforts to each tenants' unique financial circumstances as evidenced by the change in policy in 2008 when our relocation activity moved into more financially stable tenants. Future rent collection variances will be more completely explained and documented in the occupants' relocation diaries. Port Acquisition and Relocation staff's primary function is to relocate tenants and administer FAA grant spending. Any rent collected on this property is considered an FAA grant "offset" and reduces the grant reimbursable amount.

Recommendations

We recommend that Port management:

1. Strengthen controls related to rent collection.
2. Document rent reduction or collections efforts.
3. Enforce lease agreement terms and conditions in order to eliminate the appearance of favoritisms.
4. Monitor any future 3rd party management agreements and operations.

Management Response:

1. **Acquisition and Relocation Department staff, upon recommendation of the Internal Audit team, has increased its oversight and controls of rent collection.**
2. **All instances of rent variances will be documented in each tenant's relocation and acquisition diaries.**
3. **Future lease agreements will be standardized if possible to reflect uniform terms and conditions.**
4. **Port staff will closely oversee future 3rd party residential property management agreements.**

Updated 90-day Management Response:

1. **We now have increased management oversight of rent collection efforts and a mechanism is in place to collect any back rent due during the escrow process.**
2. **Relocation diaries include rent collection efforts and document variances or unusual circumstances.**
3. **No new residential lease agreements have been executed since audit findings; staff will continue to include Port Legal department for reviewing lease agreements.**

4. No residential property management agreements have been executed. Staff will be cognizant of increased contract management if the need for such agreement is realized.

2. Inadequate Controls over Cash Collection

The department does not have adequate controls over processing of cash collection which includes personal checks, cashier's checks, and money orders.

The department collects and processes monthly rents from the acquired property either directly at the department's location or indirectly through the third-party property management company. The department has processed an average of ~\$1,200,000 in rent payments for the past three years.

Risk of misappropriation is significantly higher in cash than in any other financial medium. Such high inherent risk requires adequate controls to prevent and detect potential irregularities. In the absence, management cannot be reasonably assured of accurate and complete receipt of all incoming payments.

The auditor noted a number of weaknesses in cash handling procedures. While no instances of misappropriation were noted, the extent of exceptions clearly indicates that controls over cash processing was not adequate.

The auditor noted the following weaknesses over cash handling:

- Inadequate segregation of duties. Incompatible individual duties such as opening, recording, depositing, and reconciling payments have not been properly segregated.

Management Response: Keys and deposit box access will be installed and assigned to designated staff and it will be segregated from the daily receipting and deposit preparation staff.

- Inadequately controlled physical access to incoming payments. The payment drop-off box is not secured. All staff members have access to the area, making it difficult to establish accountability if payments are missing.

Management Response: A tamper-proof, secure drop box for after hours rent payments has been ordered and will be installed by end of August, 2009.

- In a test sample of 14 rent payments, 57% of received payments were not processed timely with a time lag ranging between 3 to 33 days.

Management Response: Auditor test compared the date written on check against the date of deposit, which is not necessarily a validation of the true date of when a check was presented to Port for rental payment (e.g. tenant dated check September 1, 2008, but did not present to Port staff until September 22, 2008). All checks are now date stamped and endorsed as soon as received.

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- Inadequate oversight of the 3rd party property management company
 - One checking and one money market account were opened in the Port's name and managed by the company without Port management review or monitoring.
 - The 24-hour state law deposit requirement of public funds was not observed.
 - Checks were drawn monthly from the bank account by the management company for its services. There was no monitoring by Port management.

Management Response: While we believe that adequate controls were in place for cash collections, strengthened controls that we will implement include:

1. **Distributing daily cash receipt reports to management.**
2. **Distributing rent monthly delinquency reports.**
3. **Explaining deposits that appear to be more than 24 hours between receipt and deposit and listing them on an exception worksheet.**

Updated 90-day Management Response:

1. **Rent collection has been transferred to Accounts Receivable. Tenants are invoiced by mail and rent is sent directly to the Port lockbox via US Mail. Acquisition/Relocation Staff does not handle or manage the cash collection process.**
2. **All revenue collection efforts are now managed and controlled by Port Accounting & Financial Reporting (AFR) Accounts Receivable staff.**
3. **Not applicable, deposits should now be processed as soon as they are received by the lockbox account.**

Future 3rd Party management agreements will be closely monitored and audited for any inconsistencies. There are currently none in effect.

Without written policies or procedures and the lack of knowledge over necessary controls to properly monitor and improve processes contributed to the noted exceptions. In its current state, this condition will likely continue to hamper the department's ability to establish full accountability over public resources and to fix responsibility in cases of wrongdoing.

Management Response: Given the facts that this property will be occupied and rent collected for less than six months (expected to completely vacate prior to the end of 2009), and that there are no additional properties of this nature to be acquired and managed by the Port, we feel additional cash collection controls to be implemented above will significantly improve the departments accountability of the revenue for the remaining six months of this property management function, at which point, we expect all property to be vacant and no income received.

Recommendations

We recommend that Port management:

1. Strengthen controls related to cash collection by establishing monitoring.
2. Deposit funds within 24 hours or have an exception granted by the Port treasurer.
3. Establish segregation of employees where no employee can control any cash transaction from beginning to end.
4. Obtain a secure lock box and a safe for cash deposits.

Management Response:

1. **Department management will take an active role in the monitoring of the cash collection process.**
2. **Funds will be date-stamped upon receipt and exceptions to the 24-hour rule will be considered on a case-by-case basis.**
3. **Accountability and chain of control procedures will be implemented immediately, segregating cash collection from cash receipt documenting**
4. **A secure, lockable box for cash deposits has been installed with limited access control.**

Updated 90-day Management Response:

1. **See also previous response. Acquisition and Relocation staff has discontinued handling cash and negotiable instruments as they relate to revenue collection. A 100% mail-in system to a lock box has been implemented for remaining tenants.**
2. **Not applicable.**
3. **Acquisition and Relocation department staff no longer handle cash.**
4. **Rent payments and deposit box are no longer active at the acquisition relocation field office and consultant staff and remaining tenants have been informed in writing of the new, updated, mail-in rent payment procedures.**

3. Noncompliance with Port Procurement and Disbursement Policies and Procedures

The department does not have adequate controls over procurement and disbursement.

Port procurement policies and procedures are designed to promote equitable, just, and economical procurement of goods and services while ensuring compliance with applicable federal and state rules and regulations. In essence, compliance with Port policies and procedures would provide general public with equal access to contracting opportunities at the Port through a competitive selection process. Noncompliance however would increase risk of inappropriate (e.g., favoritism) and uneconomical (e.g., non-competitive rate) procurement of goods and services.

The auditor tested a sample of fourteen (14) vendors and noted the following noncompliance items:

- Five (5) instances where the department retained no documentation related to procurement. The auditor independently confirmed that each was advertised, but the documentation as to application, interviews, and selection was not maintained.

Management Response: Competitive bidding was performed for all of the consultant services. Previous audits (Moss Adams, 2007) cited this same issue. However, the department was directed by Engineering procurement staff in early 2008, to destroy its entire consultant interview and selection records. This directive was rescinded on July 31, 2008.

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- One (1) instance where the Port's Professional Service Agreement (PSA) template was not used. Instead, the contractor's form was used in its place. The auditor could not ascertain whether the Port's legal department had reviewed the contract before execution. As such, Port interest may not have been properly and adequately protected.

Management Response: Port staff was able to present evidence that non-standard agreement was reviewed and approved by Port Legal staff.

- Five (5) instances where services, subject to Professional Service Agreement (PSA) and Small Works (SW) procurement policies and procedures, were procured without evidence of competitive selection.

Management Response: For repairs of replacement homes, vendors were not selected by the Port but rather by the displaced person. In the case of selecting commercial moving companies, the lower of two bids for a particular household move was selected. In addition, small business participation in department expenditures represented over 70% of the payments. A global bid process for many of these services was possible but would have not achieved this level of DBE, MBE & SBE participation.

- One (1) instance where charged services to a S-type (i.e., open order contract) were out of the original scope of service. The out-of-scope services should have been subject to a separate procurement and selection process.

Management Response: Recent CPO training and guidance has already improved contract procedures and adherence to Port policies. All department personnel have attended the CPO-1 workshop and the department is in full compliance as of March 2009.

- One (1) instance where the auditor noted a series of \$100 overpayments for a total of \$1,300 to an appraisal service provider.

Management Response: Overpayments listed reflect rate and fee schedule changes for appraisal work that weren't adequately documented and amended to the original service agreement. Consultant had increased their fees for appraisal reports that required an adjustment to the value of the subject property without adequately informing the Port of Seattle of their fee schedule (from \$400 to \$500 per review appraisal).

- One (1) instance where the Port overpaid a 3rd party property management service company by \$8,000. Lack of management monitoring of the terms of the agreement contributed to the overpayment.

Management Response: This is a contract interpretation issue between vendor (Phillips Real Estate) and Port staff. It appears that Port overpaid vendor \$500 per month for services over a 16 month period (\$2,500 each billing month was paid as opposed to \$2,000 plus \$500 for eligible reimbursable costs). Port staff has contacted vendor in an attempt to resolve and recover.

A general lack of knowledge on applicable Port procurement policies and procedures contributed to the noted exceptions. If not corrected, department's procurement practices will

continue to be inadequate and likely questioned in regard to equal access to procurement opportunities at the Port, as well as the economical use of public resources on such contracts.

Recommendations

We recommend that Port management:

1. Strengthen controls related to procurement and disbursements and ensure that the entire department has the knowledge base necessary to comply with Port policies, procedures, and guidelines.
2. Ensure that every procurement file contain adequate documentation to clearly identify compliance with Port policies and procedures.
3. Recover the \$1,300 and \$8,000 overpayments noted in this finding above.

Management Response:

1. **Acquisition and Relocation Department employees have attended required CPO-1 training and have increased their knowledge, awareness and sensitivities of the procurement procedures.**
2. **All current and future Procurement and Service Agreement files now have multiple levels of management oversight and control for compliance with established Port procedure.**
3. **The overpayment of \$8,500 has been brought to the attention of the vendor and they have agreed with the Audit Team's discovery and interpretation of the agreement. They will reimburse the Port for the overpayment.**

Updated 90-day Management Response:

1. **No additional update**
2. **No additional update**
3. **Payments totaling \$5,667 have been received from vendor as part of the \$8,500 recovery. Full payment is expected prior to the end of the 2009.**