



HAMILTON ENTERPRISES, LLC

CONSULTANTS AND CERTIFIED PUBLIC ACCOUNTANTS

Harford County, Maryland Office of the County Auditor



Audit of Property Management Controls

Audit Number: 2014-A-09

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Submitted to:

Harford County Council

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Independent Auditor's Report

Background

September 2014

Audit Report Highlights

Why We Did This Audit

This audit was conducted as part of the Harford County Office of the County Auditor's Fiscal Year 2014 annual risk assessment.

What We Recommend

The County should develop methods and procedures for maintaining a comprehensive inventory of real estate assets and reconciling this listing to the Fixed Assets module.

The County should establish procedures to reconcile payments made and received for leased properties to the lease agreements while maintaining adequate segregation of duties.

Hamilton Enterprises LLC, an independent public accounting firm, was contracted by the Harford County Office of the County Auditor to perform an audit of Harford County's Property Management Controls. We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion. Accordingly, we do not express such an opinion. The procedures performed, and sufficiency thereof, were agreed to by the County Auditor. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the County Auditor, Audit Advisory Board, and those charged with Harford County governance and is not intended and should not be used by anyone other than those specified parties.

Our work was conducted in accordance with Generally Accepted Governmental Auditing Standards (GAGAS) issued by the U.S. Government Accountability Office (GAO).

Objectives and Scope

The objective of the audit was to determine if procedures are adequate to ensure that the County's rental and lease payments are proper and contracts are monitored for compliance with their terms, as well as assess the completeness and valuation of properties recorded in the County's financial records. The scope of the audit covered July 1, 2012 through June 30, 2014.

What We Found

The County's real estate inventory and Fixed Assets module do not contain all property owned by the County, impacting the County's ability to effectively and efficiently manage its real estate assets and correctly value and report its real property.

Payments for property and spaces leased to and from the County are not being reconciled to the lease agreements increasing the risk that payments are not properly authorized, classified, recorded or paid/received for the correct amounts in a timely manner.

We would like to take this opportunity to express our appreciation for the courtesy and cooperation Harford County extended to our auditors. If you have any questions or concerns regarding any of the findings please feel free to contact Nazim Hamilton at (301) 474-0147 or nazim.hamilton@usfti.com.



Nazim Hamilton, Audit Partner

1 Background

Harford County Government owns approximately 400 parcels of land, many of which are used for utilities, roadways or parks; approximately 60 properties have improvements with assessed values. There are approximately 48 leases of County property to other entities or individuals.

In addition to acquiring and disposing of real estate, the Division of Property Management, within the Department of Procurement, manages rented properties and absorbs the rental and utility expenses for departments that are not located in County-owned buildings. The division's budget for FY2015 is approximately \$3.5 million, with approximately \$2.6 million allocated to lease costs. There are approximately 30 properties that the County leases from other entities.

This audit is being performed based on the County Auditor's annual risk assessment. There are no previous management letter comments related to property management.

2 Audit Objectives

The objective of the audit was to determine if procedures are adequate to ensure that the County's rental and lease payments are proper and contracts are monitored for compliance with their terms. The audit included an assessment of Harford County's controls related to:

- Completeness of the County's real estate inventory listing (non-financial)
- Completeness and valuation of properties in the County's financial records
- Completeness, classification, and timeliness of payments for property and spaces leased to Harford County
- Completeness, classification, and timeliness of payments for property and spaces leased from Harford County
- Ensuring the County's rights and obligations are detailed in property ownership documents (deeds and public records) and/or written, executed leases.

3 Scope

The scope of the audit covered fiscal years 2013 and 2014 (July 1, 2012 through June 30, 2014) and was limited to real property owned, rented or leased by or to the Harford County government. It did not include right of ways, utility easements, infrastructure projects (e.g. roadways and bridges), agricultural preservation easements, or properties owned by the County's component units. However, if a property is owned or leased by Harford County on behalf of a component unit, it was considered in the scope of the audit. Additionally, rental payments on behalf of Housing Agency clients were not within the scope of this audit.

4 Procedures and Results

To accomplish our audit objectives, we performed the following steps:

1. *Procedure:* Interviewed Harford County property manager and other employees with responsibilities over property management and accounting and reviewed Harford County Property Management procedures.

Result: We were able to gather an understanding of the County's procedures. We also confirmed that neither the property manager nor Treasury is reconciling the lease payments received to the lease agreements.

2. *Procedure:* Obtained a listing of properties owned by Harford County as maintained by the Maryland Department of Assessments and Taxation (SDAT) and selected a sample of 25 items out of 412 items to verify that they are included in the property database and the Fixed Asset Module and compare the asset's value in the Fixed Asset (FA) Module with the sales price in SDAT's records.

Result: We found the following:

- Eight of twenty-five sampled records from the SDAT listing were not included in the Real Estate Inventory Listing maintained by the property manager for a total assessed value of approximately \$4.1 million.
- Seven of the twenty-five sampled records from the SDAT listing were not included in the Fixed Assets (FA) module. All of the missing records related to land with a total assessed value (potential understatement) of approximately \$250,000.
- All eighteen sample items recorded in the FA module were valued appropriately as compared to the sales price recorded by SDAT.

3. *Procedure:* Selected a sample of 15 items from the FA module as of June 30, 2014 and confirmed property ownership as noted in the deed or public record.

Result: All fifteen items we selected from the FA module were confirmed as being owned by Harford County based on the deed.

4. *Procedure:* Reviewed the history of lease payments made for the 27 monthly and 10 quarterly leases listed on the lease accounts payable spreadsheet, during fiscal years 2013 and 2014 to confirm accuracy, completeness and timeliness (based on the terms as defined in the lease agreement) and to confirm accurate classification in the GL.

Result: We found the following:

- Eight out of thirty-seven leases reviewed had late payments at some point during the two-year review period.
- Two leases where the lease payment had not been recorded in the General Ledger for an approximate underpayment of \$10,900.
- Two leases that appear to have been overpaid when compared to the lease agreements for an approximate overpayment of \$2,000.
- Six leases where escalations were not paid in accordance with the lease agreement, for an approximate underpayment of \$4,000.

5. *Procedure:* Reviewed the history of lease payments received for the 10 annual leases and 21 monthly leases¹ listed on the lease accounts receivable spreadsheet, during fiscal years 2013 and 2014, for accuracy, completeness and timeliness (based on the terms as defined in the lease agreement) and to confirm accurate classification in the GL.

Result: We found the following:

- Twenty-three out of thirty-one leases reviewed had late payments at some point during the two-year review period. Ten of the leases are paid on an annual basis, with seven of the ten annual leases being paid late.
- Three leases that appear to be underpaid for approximately \$11,500 when compared to the lease agreements.
- Two leases that appear to be overpaid for approximately \$3,600 when compared to the lease agreements.
- Three leases where the current lease agreement could not be located.

¹ Excludes 16 \$0-\$2 annual leases.

- Three leases that called for the tenant to pay a pro-rated portion of real estate tax, but there was no evidence that any amount had been allocated to or paid by the tenant.
 - One misclassification of a pet security deposit as rental income.
6. *Procedure:* Compared the rental expense and rental income accounts across FY 13 and FY14 to ensure amounts are properly classified (e.g. items were expensed that should have been capitalized, missing payments, misclassified payments).

Result: The calculated variance appeared reasonable and no further investigation was conducted.

5 Audit Findings and Recommendations

5.1 Completeness of the County's Real Estate Inventory Listing

Finding 1: Without a comprehensive Real Estate Inventory Listing, the County may not be able to effectively manage its real estate assets.

The County's Real Estate Inventory listing has not been kept current due to the County's planned implementation of a Facilities Master Plan.

The Urban Institute Center on International Development and Governance's *Guidebook on Real Property Asset Management for Local Governments* explains that creation of a comprehensive inventory of real estate assets is a crucial first step for establishing effective asset management. An incomplete inventory listing increases the risk that the County may not be able to manage its real estate assets effectively. For instance, information crucial to management decisions regarding the sale, retention, physical security, or impairment of assets may not be available which could result in the misallocation, misuse, or waste of resources and the inability to properly budget for capital expenditures.

Recommendation: The County should ensure the Facilities Master Plan has methods and procedures for maintaining a comprehensive inventory of real estate assets effectively and efficiently.

Management's Response:

The County agrees with the recommendation and is currently working to ensure the Facilities Master Plan has methods and procedures for maintaining a comprehensive inventory of real estate assets effectively and efficiently. The Facilities Master Plan should be completed by October, 2014. The resulting database will be operational by December 2014 and will be managed by the Department of Planning and Zoning.

5.2 Completeness and Valuation of Properties in the County's Financial Records

Finding 2: Missing real estate assets in the Fixed Assets module can impact the County's ability to properly value and report the County's properties in its financial reports.

The Fixed Assets module is set-up to identify purchases under different indexes for review and determination as to whether the purchase should be capitalized, but donated property is not identified by this process.

In accordance with Harford County's accounting policies, there is no minimum dollar capitalization threshold for Land. If the FA module does not contain all of the real estate assets owned by the County its financial records and reports may reflect the incorrect valuation for its real property.

Recommendation: The County should establish procedures to reconcile the FA module to the County's real estate inventory to ensure the completeness, physical existence, and appropriate valuation of the County's real estate in its financial records and reports, including donated property.

Management's Response:

The recommendation to establish procedures to reconcile the FA module to the County's real estate inventory will not be done since the County's real estate inventory data base has not been kept current due to the Facilities Master Plan being conducted.

Treasury has reviewed the finding on the missing real estate assets in the fixed assets module (FA module). Of the seven missing real estate assets, one had an assessed value of \$238,000 and the other six had a combined total of \$11,600 with no one property having an assessment greater than \$5,000. It appears that most of these assets are donated assets that only have an economic benefit to the County. The property that is valued at \$238,000 was obtained prior to 1961 with an assessed value of \$1,000. This property cannot be found on our Geographic Information System (GIS) which shows plats of land in Harford County. After numerous discussions with the Department of Assessments and Taxation, where they were also unable to identify the property, they did a visual inspection of the area and decided to remove the property from their records. They believe that the property has been absorbed by the neighboring lots over the years.

Treasury has instituted a new procedure in Fiscal Year 2014, designed to alert the Fixed Asset Accountant to all transactions involving real property transfers. Since the processing of deeds are done by Treasury, a new procedure has been instituted by which any deed that has Harford County, Maryland as the buyer or seller will be sent to the Fixed Asset Accountant for entering the information into our FA module.

5.3 Completeness, Classification, and Timeliness of Payments for Property and Spaces Leased to Harford County

Finding 3: Payments for property and spaces leased to Harford County are not being made in accordance with the lease agreements.

Payments are made based on the landlord's payment notices and are not being reconciled back to the lease agreement to ensure that amounts are not over or underpaid. Harford County Code at § 41-25 states that the Board of Estimates shall approve all purchases, sales or leases of real property. It is imperative that the lease payments made comply with the approved lease agreements, including escalations, to ensure the payments are properly authorized, made in a timely manner, and to avoid over or underpayments.

Recommendation: The County should establish procedures to reconcile payments made based on statements received from landlords to the lease agreements on a monthly basis while maintaining adequate segregation of duties among those that authorize the lease, make the lease payments, and conduct the reconciliation.

Management's Response:

The County agrees with this recommendation. We currently have adequate segregation of duties for the authorization of the lease, payments and reconciliation. The Board of Estimates and the signing of the lease by the Director of Procurement is the authorization of lease agreements. The duties of making payment is done by our Administrative Assistant entering the lease payment into our ERP system whereas the approving of the payment by the Chief of Property Management is the reconciliation of payments since her approval is based on checking the leases to the payments being made for that month.

5.4 Completeness, Classification, and Timeliness of Payments for Property and Spaces Leased from Harford County

Finding 4: Lease payments from tenants are not monitored to ensure they are correct and timely.

Harford County Code § 41-25 states that the Board of Estimates shall approve all purchases, sales or leases of real property. It is imperative that the lease payments received comply with the approved lease agreements, to ensure the lease of the property is authorized, payments are received in a timely manner, and payments are for the correct amount. Additionally, reconciliation functions as a control to detect payments that may be misclassified in the improper account (i.e. security deposits) and/or the improper time period improving management's ability to assert that it's financial records are valid, complete and accurate.

Recommendation: The County should establish procedures to reconcile payments received to the lease agreements on a monthly basis while maintaining adequate segregation of duties among those that authorize the lease, receive the lease payments, and conduct the reconciliation. Demand letters should be sent for any missing payments on a monthly basis (potentially adding penalties and interest) so that management fulfills its stewardship duties over its leased assets and cash collections. The County should consider sending reminder or billing notices prior to the due date to tenants with leases paid on an annual basis.

Management's Response:

The County agrees with the recommendation and our current procedures do have adequate segregation of duties. Our current procedures have Treasury collecting and depositing rental payments and forwarding a spreadsheet of lease payments received for the month and the date of receipt to Procurement. Upon receiving the spreadsheet, Procurement will reconcile the payments to the lease agreements. Any missing payments or payments not made in accordance with the lease will be reviewed and a phone call or a letter will be sent to the tenant. Property Management will consider sending notices in future. As stated previously, the Board of Estimates and the Director of Procurement in signing the lease is the authorization of all leases in the County.