

County of San Bernardino

Auditor-Controller/Treasurer/Tax Collector
Internal Audits Section

Department of Airports:

**Airports Lease Revenue and
Security Deposit Audit**



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SUBJECT: AIRPORTS LEASE REVENUE AND SECURITY DEPOSIT AUDIT

In compliance with Article V, Section 6, of the San Bernardino County Charter and County Policy 05-20 entitled Internal Operational Auditing, we have completed an audit of the Department of Airports' lease revenue and security deposits for the period of January 1, 2016 through March 31, 2017. The primary objectives of the audit were to determine if policies and procedures over lease revenues and security deposits are in place and if controls over lease revenues and security deposits are in place and operating effectively. We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing established by the Institute of Internal Auditors.

We identified several procedures and practices that could be improved. We have listed these areas for improvement in the Audit Findings and Recommendations section of this report.

We sent a draft report to the Department on June 28, 2017 and discussed our observations with management on July 26, 2017. The Department's responses to our recommendations are included in this report.

We would like to express our appreciation to the personnel at the Department of Airports who assisted and cooperated with us during this engagement.

Respectfully submitted,

Oscar Valdez

Auditor-Controller/Treasurer/Tax Collector
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By:

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Department of Airports:

Airports Lease Revenue and Security Deposit Audit

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Summary of Audit Results

The table below summarizes the audit findings and recommendations for this audit engagement. For further discussion, refer to the *Audit Findings and Recommendations* section of this report.

| Finding No. | Findings and Recommendations | Page No. |
|-------------|--|----------|
| 1 | Written departmental policies and procedures regarding lease revenue and security deposits could be improved. | 4 |
| | We recommend management develop, implement and communicate official policies and procedures over delinquent accounts and credit card processing and acceptance. Also, management should ensure policies and procedures are updated and kept in a centralized location. | |
| 2 | Segregation of duties could be improved. | 5 |
| | We recommend management become familiar with the County's ICCM. Management should also reorganize assignments with existing staff to have effective segregation of duties and reduce the risk that any one person could conceal errors and irregularities. | |
| 3 | Deposit procedures could be improved. | 6 |
| | We recommend documented reviews over the deposits be conducted to ensure accuracy. We also recommend the review should be performed by someone of a supervisory level. | |
| 4 | Controls over lease payments could be improved. | 7 |
| | We recommend management ensure lease files are up to date and late fees are properly applied to tenant accounts. | |



AIRPORTS LEASE REVENUE AND SECURITY DEPOSIT AUDIT

The Department

The County of San Bernardino Department of Airports (Airports) provides for the management, maintenance and operation of six county-owned airports. These airports include Chino Airport, Apple Valley Airport, Barstow-Daggett Airport, Twenty-nine Palms Airport, Needles Airport and Baker Airport. The department currently manages more than 500 leases for purposes ranging from aircraft parking and storage to major aviation developments. Depending on the nature of the lease agreement, the Real Estate Services Department also provides assistance with the management, execution, and termination of the Airports' leases.

Lease Revenue

Lease revenue was recognized as monthly or annual payments collected for buildings, property, space, and land owned by the Department of Airports. Furthermore, lease revenue was identified when a formal lease or rental agreement, license, or use permit had been established between the County and tenant, and executed by the Director of Airports or Real Estate Services Department. Specifically, lease revenue is collected for the occupation or use of Airports land, Airports buildings, and commercial hangers or tie down spaces intended for storage of aircraft of aeronautical use.

Security Deposits

Security deposits were defined as a sum of money set aside from the payment of rent that a landlord requires a tenant to pay. It is to be kept separately in a fund for use should the tenant cause damage to the premises or otherwise violate terms of the lease. The Department of Airports generally requires a security deposit equal to one month's rent or unless otherwise stated on the lease agreement or use permit. Furthermore, Airports does not require a security deposit if the tenant's payments are provided on an annual basis.



Scope and Objectives

Our audit examined the controls over lease revenue and security deposits for the period of January 1, 2016 through March 31, 2017.

The objectives of our audit were to:

- Determine if policies and procedures over lease revenues and security deposits are in place.
- Determine if controls over lease revenues are in place and operating effectively.
- Determine if controls over security deposits are in place and operating effectively.

Methodology

In achieving the audit objectives, the following audit procedures were performed, including but not limited to:

- Reviewing the Department's policies and procedures.
- Interviewing Department personnel that were directly involved in the lease revenue and security deposit processes.
- Walk-through of activity.
- Examining original source documents and system generated reports.



Finding 1: Written departmental policies and procedures regarding lease revenue and security deposits could be improved.

The Internal Controls and Cash Manual (ICCM) Chapter 2 – Internal Controls states that the premise of an effective internal control structure is the Department’s control environment, which includes elements such as management’s philosophy and operating style and personnel policies and practices. It is imperative that management establishes internal controls, such as policies and procedures, and communicates them to the operating personnel.

The following conditions were identified:

- There were no written policies and/or procedures for critical processes in the collection of lease revenue such as procedures for delinquent accounts and credit card processing and acceptance.
- Policies and procedures were outdated and not kept in a centralized location.

When there are no written procedures, processes may be inconsistent and impact the Department’s ability to operate efficiently and effectively.

Recommendation:

We recommend management develop, implement and communicate official policies and procedures over delinquent accounts and credit card processing and acceptance. Also, management should ensure policies and procedures are updated and kept in a centralized location.

Management’s Response:

The Department of Airports has created a policy for Procedures to Send Delinquent Accounts to Central Collections that supplements the existing policy for Pay or Quit Notice Procedures. The Department continues to update existing policies while identifying the need to create new policies including Procedures for the Acceptance of Credit Card Payments.

There is currently a Department Policy Book located at the Administration Office, the Apple Valley Airport Office, and the Chino Airport Office. A digital copy of the Department Policy Book is also stored on the Department’s shared drive to ensure all employees have access. The Department has begun the practice of notifying all staff members of changes or additions to the policy book via e-mail.



Auditor's Response:

The Department's actions and planned actions will correct the deficiencies noted in the finding.

Finding 2: Segregation of duties could be improved.

According to the Internal Controls and Cash Manual (ICCM) Chapter 6 – Receipts states that two or more employees should be present when mail is opened. The department may choose to use video surveillance. In addition, Chapter 2-3 states that no one person should be assigned concurrent duties that would allow him/her complete control over a transaction or an asset.

The following conditions were identified:

- The handling of mail containing payments are being collected and opened by only one employee.
- Any available staff at the admin office were permitted to take credit card payments and issue county receipts. The Fiscal Specialist created receipts for credit card payments and also posted payments.
- Reconciliations for lease revenues are being performed by the same employee who prepared bank deposits and the CR-D forms.

Staff was not aware of the ICCM guidelines for opening mail and reviewing reconciliations. If two or more employees are not present when opening the mail, the risk of theft or loss of cash is greatly increased. The risk of undetected errors and potential theft also increases when duties are not properly segregated.

Recommendation:

We recommend management become familiar with the County's ICCM. Management should also reorganize assignments with existing staff to have effective segregation of duties and reduce the risk that any one person could conceal errors and irregularities.

Management's Response:

Management has become familiar with the County's ICCM and has contacted Internal Audits for assistance in the development of compensating controls due to limited staffing. Work Expectation Memos are being developed for each position that will outline duties, roles, and responsibilities for the Accounts



Payable, Accounts Receivable, and Staff Analyst desks to ensure segregation of duties.

Auditor's Response:

The Department's planned actions will correct the deficiencies noted in the finding.

Finding 3: Deposit procedures could be improved.

According to the Internal Controls and Cash Manual (ICCM) Chapter 9 – Bank Accounts states that supervisors must verify that deposits are intact.

During our review of 13 randomly selected deposits, nine did not have evidence of supervisory review on the deposit slip.

Staff was unfamiliar with the ICCM's guidelines on deposits. Inaccurate or untimely deposits may occur if there is no supervisory review of the Department's deposits.

Recommendation:

We recommend documented reviews over the deposits be conducted to ensure accuracy. We also recommend the review should be performed by someone of a supervisory level.

Management's Response:

The Department has begun the practice of having a staff member of supervisory level review the deposit and initialing on the deposit slip indicating that the deposit is complete. Additionally, a staff member of supervisory level will be conducting a monthly reconciliation of all deposits.

Auditor's Response:

The Department's actions and planned actions will correct the deficiencies noted in the finding.



Finding 4: Controls over lease payments could be improved.

According to the ICCM Chapter 2 - Internal Controls states that all transactions and pertinent events should be accurately and properly recorded on documents and records. Sufficient and relevant data should be recorded to provide an audit trail and to document evidence that a transaction took place. If a payment is not made by the due date, contract terms for lease agreements indicate that a late penalty fee must be paid.

The following conditions were noted when 24 lease payment transactions were tested:

- Four payments where the tenant paid less than the lease agreement.
- Four transactions where payment was late and late fees were not collected.

The Department does not have a process in place to monitor or review contracts or lease agreements for any changes or modifications to lease terms on a regular basis. The risk of undetected errors and loss of lease and fee revenue may increase if records are not regularly updated to reflect contracts or lease agreement terms.

Recommendation:

We recommend management ensure lease files are up to date and late fees are properly applied to tenant accounts.

Management's Response:

The Department has created a spreadsheet to track lease increases that is being utilized to conduct a 100% audit of tenant files throughout this fiscal year to ensure tenants are paying the correct lease agreement amount. The Department is also in the process of licensing an Airport Lease Management program that will facilitate the tracking of lease increases. The new program will have the ability to automatically apply late fees to delinquent accounts per their lease agreement terms, a feature that is absent in the current leasing program.



Auditor's Response:

The Department's actions and planned actions will correct the deficiencies noted in the finding.