Office of Audits
Office of Inspector General
U.S. General Services Administration

Audit of the Public Buildings Service, Southeast Sunbelt Region's Lease Administration Practices

Report Number A120023/P/4/R12011
September 27, 2012

Office of Audits
Office of Inspector General
U.S. General Services Administration

REPORT ABSTRACT

OBJECTIVE

Our objective was to determine if the Southeast Sunbelt Region's Leasing Division employs lease administration policies and procedures that minimize financial gains or losses on leased inventory as required by Public Buildings Service (PBS) policy.

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WHAT WE FOUND

We identified the following during our audit:

Finding 1 – PBS's emphasis on aggregate funds from operations performance masked individual property performance.

Finding 2 – PBS's poor lease administration practices resulted in payment and billing errors.

WHAT WE RECOMMEND

Based on our audit findings, we recommend that the Regional Commissioner of PBS:

1. Implement a process to review and evaluate the financial performance of each individual property, instead of focusing solely on the aggregate performance measures for the leased portfolio; and

2. Implement processes to ensure that changes to the lease, rent payments, and Occupancy Agreements are processed timely, accurately and in accordance with PBS lease administration policy.

MANAGEMENT COMMENTS

Management generally agreed with our findings and recommendations. **Appendix B** contains management's response in its entirety.

Office of Audits
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DATE:	September 27, 2012
TO:	John E.B. Smith Regional Commissioner for PBS (4P)
FROM:	Nicholas V. Painter Regional Inspector General for Auditing Southeast Sunbelt Office of Audits (JA-4)
SUBJECT:	Audit of the Public Buildings Service, Southeast Sunbelt Region's Lease Administration Practices. *Report Number A120023/P/4/R12011*

This report presents the results of our audit of the Public Buildings Service, Southeast Sunbelt Region's lease administration practices. Our findings and recommendations are summarized in the Report Abstract. Instructions regarding the audit resolution process can be found in the email that transmitted this report.

Your written comments to the draft report are included in **Appendix B** of this report.

If you have any questions regarding this report, please contact me or any member of the audit team at the following:

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On behalf of the audit team, I would like to thank you and your staff for your assistance during this audit.

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Introduction

The Southeast Sunbelt Region's (Region 4) Leasing Division[1] is responsible for lease acquisition and space management throughout Region 4. The division evaluates client agency space requirements; markets space needs; negotiates and implements leases and Occupancy Agreements (OAs); assigns space; and participates in new construction and renovation/alteration projects.

The Public Buildings Service (PBS) collects rent revenue from federal agencies housed in leased properties, which it deposits into the Federal Buildings Fund (FBF)[2] and uses to pay rent to lessors. The Pricing Desk Guide requires that rent charged to tenant agencies be a pass-through of the rent charged in the underlying lease contract, plus a fee[3] that covers PBS's cost of managing the leased inventory. In accordance with the guide, PBS generally applies a 4-7 percent fee.[4]

Rental revenue remaining after deducting all direct and indirect expenses (excluding depreciation) is considered Funds from Operations (FFO). PBS estimates that maintaining FFO between 0 percent and 2 percent of revenues[5] ensures that the leasing program operates on or close to a break-even basis. In fiscal year (FY) 2011, Region 4's leased building inventory generated rental revenue of $607.0 million and had Rental of Space expenses of $565.5 million. After deducting other expenses, the region's FFO was $12.5 million[6] (2.06 percent of lease revenues).

To evaluate the efficiency of its leasing operations, Region 4 uses performance measures provided by Linking Budget to Performance (LB2P)[7] and the National Performance Plan for FY 2011. The Region's LB2P target in FY 2011 was to break even on its leased inventory FFO, while the National Performance Plan for FY 2011 states that PBS should manage its leased space so that the aggregate FFO is between 0-2 percent of the leased inventory revenue.

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[1] Formerly referred to as the Real Estate Acquisition Division (READ).

[2] The Federal Buildings Fund is a revolving fund that provides financing for real property management and related activities, including operation, maintenance, repair of federally owned buildings, and the construction of Federal buildings, courthouses and land ports of entry. Expenses are financed from rental charges assessed to occupants of GSA-controlled space.

[3] The fee is designed to cover PBS's contract risk and lease acquisition and administration services.

[4] The standard PBS fee for leased space is 7 percent. PBS reduces the fee to 5 percent for lease assignments designated as non-cancellable. The fee is further reduced to 4 percent for tenant agencies that occupy space in United States Postal Service controlled properties.

[5] This target is lower than the PBS fee of 4-7 percent because it accounts for risk and costs incurred by PBS while managing the leased Portfolio.

[6] This number excludes revenue generated by Portfolio Leases at the Atlanta Federal Center and the King Building in Miami. Central Office also excludes these two buildings from the Region 4 Linking Budget to Performance Leased FFO measure.

[7] The LB2P program provides PBS a method to distribute a portion of its budget to regions for improving performance and exceeding performance targets.

The audit objective was to determine if the Region 4 Leasing Division employs lease administration policies and procedures that minimize financial gains or losses on leased inventory as required by PBS policy.

See ***Appendix A*** – Purpose, Scope, and Methodology for additional details.

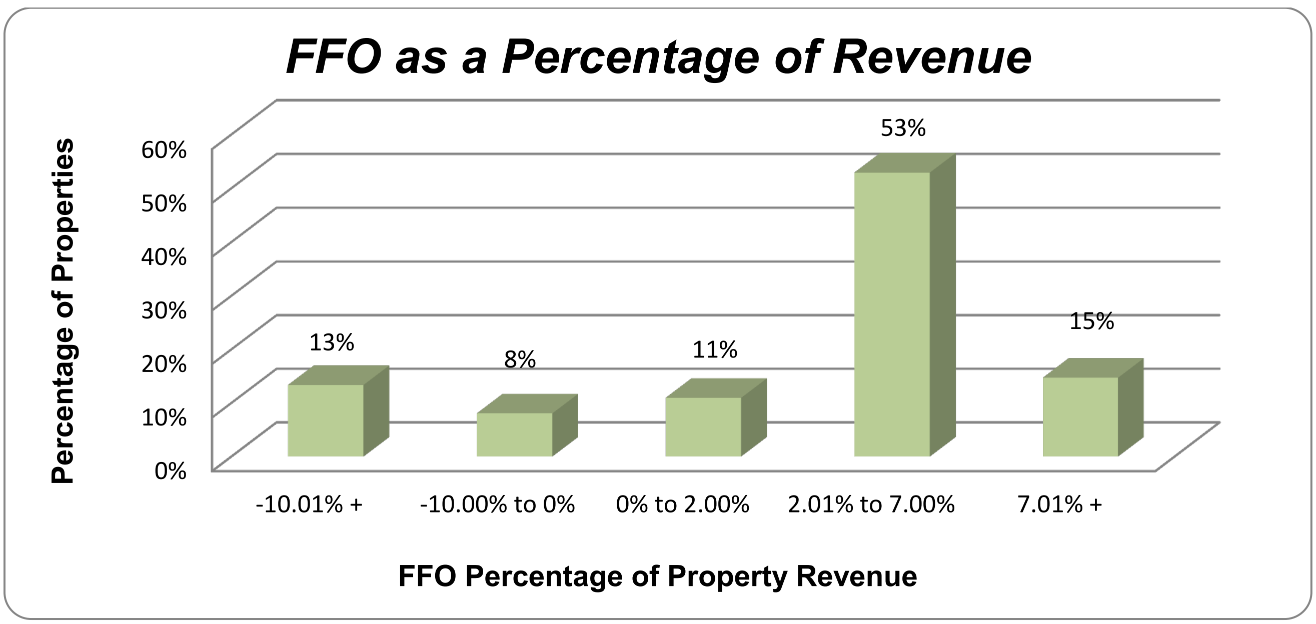
Results

Finding 1 – PBS's emphasis on aggregate funds from operations performance masked individual property performance.

The performance measures provided by LB2P and the National Performance Plan focus on overall leased portfolio performance and incentivize the region to meet aggregate FFO results. This focus on aggregate FFO measures presents a misleading picture of the Region's performance. In FY 2011, 344 out of 1,535 properties had negative FFO totaling $17.7 million, while 219 properties generated returns that exceeded the 7 percent fee PBS charged to its tenants.

Figure 1 shows the ranges of FFO, within the Region's portfolio, as a percentage of revenues and the percentage of properties within each range. As can be seen, only 11 percent of Region 4's leased properties generated FFO within the targeted 0–2 percent range.

Figure 1



<u>**Recommendation 1**</u>

To more accurately portray the effectiveness of the Leasing Division's lease administration practices and adherence to PBS policy, the PBS Regional Commissioner should implement a process to review and evaluate the financial performance of each individual property instead of focusing solely on the aggregate performance measures for the leased portfolio.

Finding 2 – PBS's poor lease administration practices resulted in payment and billing errors.

The Region 4 Leasing Division procedures did not ensure timely and accurate processing of changes to lease and OA terms. Consequently, PBS made erroneous payments to lessors and incorrectly billed tenant agencies, impacting the Region's FFO and its contributions to the FBF.[8]

PBS's untimely processing of rental rate adjustments caused erroneous payments to lessors.

The Region 4 Leasing Division did not consistently adjust rental rates in accordance with lease terms for 15 of the 39 properties (38.5 percent) reviewed. These inconsistencies led to delays that resulted in erroneous payments to lessors in FY 2011 and in prior years. The erroneous payments and corrections for prior years' errors increased FFO by $1,998,262 in FY 2011. In five cases, PBS did not make required rental rate increases, resulting in total underpayments of $385,356 and overstated FFOs. Conversely, in 10 instances, PBS did not make downward adjustments, thus overpaying the lessors by $2,383,619 and understating the FFOs.

The Lease and Supplemental Lease Agreements establish the schedule for the application of these adjustments, which generally occur once tenant build-out costs have been fully amortized; when space requirements change; or in anticipation of market changes during the life of the lease.

The delays occurred because PBS information systems rely on manual processes to make the appropriate adjustments. While PBS's Real Estate across the United States (REXUS)[9] system automatically tracks when rental rate adjustments are to occur and notifies PBS personnel when changes are necessary, it does not automatically implement the changes. Further, PBS personnel stated that REXUS could not provide them with a report showing all upcoming changes. Consequently, they use manual processes to track this information and implement the changes. As a result, some of the required changes were not processed in a timely manner. While many of the leases impacted by these errors were setup prior to PBS's conversion to REXUS from the System for Tracking and Administering Real Property (STAR), the errors continued after REXUS went live, though less frequently.[10]

The Leasing Division should implement controls that ensure changes affecting the lessors' payments are processed timely and accurately.

[8] The impacts to the FFO included errors made in FY 2011 and correcting entries from errors made in prior fiscal years.
[9] REXUS is currently used by PBS to manage the Government's real property assets. PBS transitioned from STAR to REXUS in July 2011.
[10] STAR did not automatically track when rental adjustments were necessary or notify personnel when changes were appropriate.

PBS's inaccurate execution of Occupancy Agreements resulted in erroneous and late billings to tenants.

PBS executed OAs using erroneous rates and data. Since OAs confirm the tenant agencies' financial commitment to pay the agreed upon rent, failure to accurately execute them can result in erroneous rent bills to the tenant agencies, and can impact PBS's FFO.

The Pricing Desk Guide states that OAs shall be activated for all new space assignments and when changes to existing agreements are warranted.[11] In these instances, PBS personnel must manually process the change or activation in PBS systems. Such updates do not occur automatically and require a contracting officer's approval prior to finalization.

PBS did not accurately process changes to 10 OAs for the leases reviewed. In another instance, PBS failed to activate the OA prior to the effective date of the succeeding lease; as a result, the tenant was not billed until 18 months after the succeeding lease began. In five cases, PBS overbilled tenants by a total of $655,113; in six, PBS under-billed by $1,297,095. In total, these errors resulted in $1,952,208 in billing errors.

The Leasing Division's failure to follow established billing procedures resulted in tenant agencies being billed incorrectly and negatively impacted the FBF and the Region's FFO. The leasing division should reinforce its policies, ensuring that OAs are processed timely and accurately and tenant agencies are billed properly.

PBS's untimely processing of lease holdovers resulted in late or missed payments to lessors.

For 5 of the 39 properties, PBS failed to process paperwork that changed the status of the lease from expired to holdover in a timely manner. As a result, payments to the lessor stopped, making these leases appear to be overly-profitable. However, the FFO will be negatively impacted when catch-up payments are made.

Per the Leasing Desk Guide,[12] when the Federal Government occupies space after a lease has expired but prior to executing a succeeding or new lease, PBS must continue to make monthly rental payments at the then-current rental rate stated in the expired lease.[13] In these cases, payments to the lessors ceased at lease expiration since neither STAR nor REXUS automatically established holdover status. Both systems require that PBS perform this task manually. For two of the properties, payments to the

[11] OA revisions may be necessary when the tenant agency expands or reduces space at an existing location; services are added or removed; PBS agrees to fund additional tenant improvements; or PBS and the tenant agency mutually agree to revise the OA terms.

[12] Chapter 10, Section 2 (Lease Holdovers, Standstill Agreements, and Condemnations)

[13] The continuing rent payments are also a requirement in standstill agreements that preserve the status quo between the lessor and the Government. If a holdover is not avoided, signing a standstill agreement may mitigate negative impacts to the lessor and reduce the possibility of the lessor placing claims against GSA for damages.

lessors ceased in FY 2011 and increased the FFO by $108,537. For three of the properties, PBS made catch-up payments to the lessor or made accounting accruals that reduced the FY 2011 FFO by $550,978.

PBS may ultimately be held responsible for reimbursing the lessor for damages incurred due to late or missed payments.[14] PBS should take steps to ensure that lease holdovers are administered in accordance with leasing policy and that lessors are paid appropriately.

PBS's improper accounting practices led to the inaccurate reporting of individual property's funds from operations.

PBS erroneously directed the rent revenue to one property while charging expenses to another, or vice versa, for five of the properties reviewed. In total, $3,337,439 was assigned to incorrect buildings. This distorted the FFO numbers for the affected properties.

When the lease projects for the five properties were created in STAR or REXUS, PBS leasing specialists incorrectly tied the revenue and expense streams to non-related properties. Four of the five properties were incorrectly linked together, while one was linked to a property outside of our sample. In one instance, PBS was aware of the inaccuracy but chose not to correct the issue because the lease was nearing expiration and the error did not affect the Region's overall FFO performance goals. PBS officials acknowledged that the FFO for the property had been incorrect for the entire term of the lease.

PBS evaluates the financial performance of each property on a monthly basis based on its revenue and expense data. Without accurate recording and reporting of this data, the FFO of a property is misstated and cannot be relied upon for this evaluation. Leasing division officials should take measures to ensure that assets are correctly setup in PBS systems and the corresponding operating results are accurately reported and recorded.

Recommendation 2

We recommend that the PBS Regional Commissioner implement processes to ensure that changes to the lease, rent payments, and OAs are processed timely, accurately and in accordance with PBS lease administration policy.

[14] Per FAR Subpart 32.9 Prompt Payment, GSA may be subject to late payment interest penalties.

Other Observations

We identified other issues that led to excessive gains and losses on individual properties:

1. In five instances, PBS overpaid the lessor through duplicate payments, missed commissions, and parking credits. These overpayments totaled $620,680. As of the end of audit field work, $288,323 had not yet been recovered.

2. In three instances, PBS failed to make payments to the lessor in the period due. This occurred because of an ownership change; late lease activation; and correction to duplicate lease numbers. The affected payments totaled $299,228.

3. In one instance, a lease was terminated at the convenience of the tenant agency in October 2009, but PBS has not been able to backfill the space. PBS attempted a buyout, but was rejected by the lessor. PBS is committed to pay the lessor through April 2016. The cost of this vacant space to the Region was approximately $1.4 million in FY 2011. As tenant agencies seek to reduce space, PBS is at risk of incurring additional costs associated with vacant space and buyouts.

4. In FY 2011, Region 4's FFO was decreased by $871,849 as a result of accounting rules that impact how free rent, step rent and broker commissions are recorded.

Conclusion

In FY 2011, nearly 90 percent (1,372 out of 1,535) of the properties in Region 4's leased inventory operated with profits or losses outside the 0-2 percent FFO target range. While the Region's aggregate FFO results approached PBS's performance measure objectives, these results are misleading, as the profits and losses offset one another, and give a false impression that the Region operates efficiently within its lease fee structure. The Region did not always follow procedures to ensure timely and accurate processing of changes to lease and OA terms, which led PBS to send erroneous payments to lessors and incorrectly bill tenant agencies, thus impacting the Region's FFO and contributions to the FBF.

The Region 4 Leasing Division can more accurately assess the efficiency of its operations by implementing a process to review and evaluate the financial performance of each lease or property, instead of focusing solely on the aggregate performance measures for the leased portfolio. Additionally, the Leasing Division should implement processes to ensure that changes to the lease, rent payments, and OAs are processed timely, accurately and in accordance with PBS lease administration policy.

PBS management stated that they are aware of these findings, and indicated that they had begun working on corrective actions prior to completion of the audit.

Appendix A – Purpose, Scope, and Methodology

Purpose

This audit was included in the GSA Office of Inspector General's FY 2012 Audit Plan.

Scope

Our audit was based on a review of properties and leases in Region 4's leased building portfolio. The properties selected for testing were chosen because of their excessively positive or negative FFO results in FY 2011. In addition, we assessed controls in the Leasing Division based on applicable leasing policies, procedures, standards, and guidance.

Methodology

To accomplish our objective, we:

- Reviewed PBS's directives, internal policies and procedures pertaining to the leasing process;
- Conducted meetings and interviews with employees from Region 4's Leasing Division, Portfolio Group, and Budget & Financial Management Division;
- Interviewed other cognizant GSA employees;
- Reviewed guidance on leasing provided by GSA and other federal agencies;
- Reviewed audit reports from the GSA OIG and other agencies associated with leasing practices;
- Performed a walk-through of the "loser lease" research process with Portfolio Group and Leasing Division employees;
- Selected and examined a sample of properties with excessively positive and negative FFO; and
- Reviewed leases and documentation supporting payments to lessors and invoices to tenant agencies in FY 2011.

We conducted the audit between December 2011 and March 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Internal Controls

We limited our assessment of internal controls to those related to the leasing practices performed throughout Region 4. We reviewed GSA's and the Leasing Division's policies and procedures, performed audit procedures to assess the effectiveness of the controls, and made recommendations to strengthen and improve the controls discussed in the Results section of this report.

Appendix B – Management's Comments

GSA

GSA Southeast Sunbelt Region

September 13, 2012

MEMORANDUM FOR: Nicholas V. Painter
Regional Inspector General for Auditing
Southeast Sunbelt Office of Audits (JA-4)

SUBJECT: Audit of the Public Buildings Service, Southeast Sunbelt Region Lease Administration Practices
Report Number A120023/P/4/Xxxxx

THRU: John E.B. Smith
Regional Commissioner, PBS (4P)

FROM: Dawn Norman
Dawn Norman, Director
Leasing Division (4PR)

Victoria L Corkren
Victoria Corkren, Director
Portfolio Management Division (4PT)

Gwendolyn Gladman
Gwendolyn Gladman, Acting Director
Budget and Financial Management Division BCPA)

Attached is our response to the Draft Audit Report referenced above. This response was prepared jointly by the Leasing Division, Portfolio Management Division, and the Budget and Financial Management Division.

We are all available to answer questions you may have about our response. We agree and acknowledge that additional controls are needed, and as indicated have implemented them as a result of this Audit. In some cases, we recognized the need prior to your report and instituted processes to mitigate erroneous reporting of profits and/or losses on the leased buildings within the Region.

Thank you for the opportunity to provide comments and we look forward to receiving your final report.

Please contact us if you have questions.

Cc: John E. B. Smith, Regional Commissioner
Shyam Reddy, Regional Administrator

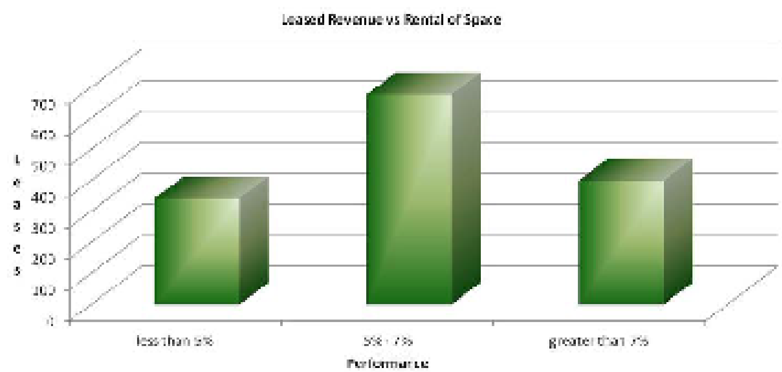
General Services Administration
Public Buildings Service
77 Forsyth Street
Atlanta, GA 30303

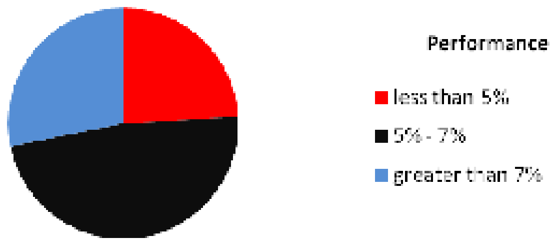
Finding 1 – PBS's emphasis on aggregate funds from operations performance masked individual property performance

Region 4 PBS acknowledges and agrees that the organization's emphasis on aggregate funds from operations performance can mask individual property performance. As a result, in January 2012, we implemented a Lease Analysis review of all leases outside of a 5-7 percent threshold to determine "winner" and "loser" leases. This threshold is calculated based on a percentage of actual rental expense, which more closely aligns to the actual calculation of the PBS fee (5% for non-cancellable leases and 7% for cancellable leases). The analysis results in more relevant observations and allows us to monitor and respond on a lease-by-lease basis.

The threshold analysis is initiated by the Portfolio Management Division ("Portfolio"). After the analysis is performed, the Leasing Division ("Leasing") makes any necessary lease corrections and submits the corrective actions to the appropriate systems (i.e. REXUS). The Budget & Financial Management Division ("Budget") submits any subsequent necessary actions to the Ft. Worth Finance office. Due to the extremely large volume of leases in our portfolio (more than 1,500), the region uses a progressive review process during the "Monthly Measures" meeting between Leasing, Portfolio and Budget to address those leases that fall outside of the threshold.

The graph below is the current snapshot of our Lease Analysis; and due to the efforts underway, better results are expected by fiscal year-end. Going forward, the region will continue to use this process to monitor individual lease performance and make corrections and adjustments as necessary. The region strongly believes that this effort will ensure that we continue to see improvement each month.





The report references "FFO as a Percentage of Revenue" in Figure 1 and relates it to Leasing's performance. Based on this measure, the report shows that only 11% of the region's leases fall within the 0-2% range of this measure. According to Central Office, Portfolio Management Division, this metric is an 'external' measure used exclusively for reporting purposes to the Office of Management and Budget (OMB). As such, "FFO as a Percentage of Revenue" is only tracked at the national level and is not used to track regional performance. The more appropriate measure to review is the Linking Budget to Performance "Leased FFO" that measures PBS's revenue less expenses (excluding depreciation) for leased buildings. This measure is tracked by Central Office and examines each region in the aggregate. As of September 10, 2012, the August results for this measure show a total leased FFO nationally of ($36.8M), four regions (1, 3, 4, and 8) are reflecting positive totals; at the time of this report, Region 4's total is $5,440,617.

Finding 2 – PBS's poor lease administration practices resulted in payment and billing errors

<u>PBS's untimely processing of rental rate adjustments caused erroneous payments to the lessors</u>

Region 4 PBS agrees that there have been delays in processing rental payment changes that caused incorrect payments to lessors. As the report acknowledges, the former program, System for Tracking and Administering Real Property (STAR), did not have any way of tracking increases or decreases in the rental payments due, which resulted in the entire process being tracked manually. This manual process missed many of the required changes to rent payments. The new system, Real Estate across the United States (REXUS), while better because it provides an automatic reminder to the Realty Specialist, still requires a manual process to actually enter the new payment documents in the system. Therefore, additional controls are necessary to ensure timely processing.

The region has modified its current review process for step rental payments to lessors to add additional controls to the REXUS notification to the Realty Specialist. Now, at the time the lease is reviewed for Consumer Price Index (CPI) Operating Cost escalation payments by the Data Management Group (DMG), any necessary step rental adjustments (up or down) are also reviewed. This CPI review by the DMG occurs annually at the anniversary date of the lease; at the time when most rental adjustments are due. In the event that the Realty Specialist has not already processed the required rental change, the DMG review will follow up with the Realty Specialist and monitor that the changes are processed. The list of pending CPI actions for each month is tracked and monitored by the DMG Project Manager to ensure all

CPIs are completed in a timely manner. To further streamline this process, the region recently switched from using hard copy lease files to utilizing eLease to conduct the CPI reviews during the anniversary month.

As an additional measure, the region generates a report from REXUS on the 1st and 10th of each month that identifies all R620 Payment Documents that are awaiting approval from the Contracting Officer. This report is distributed to the Branch and Section Chiefs for follow up.

The Region believes that this two-phased approach to reviewing the leases annually will ensure we process the required paperwork for rental rate adjustments in a timely manner thereby reducing the instances of erroneous payments.

<u>PBS's inaccurate execution of Occupancy Agreements resulted in erroneous and late billings to tenants</u>

Region 4 PBS acknowledges that Occupancy Agreements (OAs) are not always processed timely resulting in erroneous and late billings to tenants. In an effort to improve our performance on "Late OA Activation" measures, the region recently initiated a process to require a signature on OAs before the Request for Lease Proposals (RLP) are issued on the market. This means that the region will not begin procurement without an agency's signature that authorizes the budget estimated funding for the project. At this point, the region is able to bill the agency timely as we will have a signed OA from which to bill. It should be noted that this effort will only impact new or expansion actions. It is at this time, before the requested space action begins, that PBS is most likely to obtain timely signatures on the OA by the agency.

The situation that is more likely to result in erroneous or late billings to tenants is when an agency does not sign the OA and we need to begin a follow on lease action such as a succeeding lease. The current Rent Bill Management (RBM) process does not allow PBS to bill an agency without a signed OA in a succeeding lease; therefore, absent a signature we are forced to enter into extensions and/or holdover situations which are problematic, timely, and costly. This region has put forth a proposal to Central Office to adjust this process and allow us to proceed with a succeeding lease and bill an agency when they are still occupying the space, thus protecting our contractual position with the building owner. Until this new process is approved, we will continue processing extensions, since Central Office RBM allows billing during an extension period.

Timely OA activation relies not only on the processing of proper paperwork on PBS's side, but also timely action on the agency's side to sign the OA and return to PBS. When we issue an OA to the agency and they fail to return it timely, we have established an escalation process that reviews all pending OAs. The process for this review and escalation is as follows:

1. DMG creates the list on the 16th of the month (first business day after billing).
2. The list goes to Portfolio, Asset Management Branch (4PTA) for review. The Asset Manager (AM) determines the validity of each OA and version, requests removal of OAs and requests to add OAs. 4PTA also determines which OAs will be an exception candidate.
3. If any OAs are to be removed, the RBM Team has to concur and will request DMG to remove from the list.
4. DMG re-runs an updated list after the review by 4PTA and RBM Team.
5. DMG sends the updated list back to Portfolio.

6. RBM Team will add prior months' comments to the list before the list is sent to Client Solutions Division ("Client Solutions").
7. Portfolio sends the list to Client Solutions for signature attempt.
8. Client Solutions sends the list back with comments to Portfolio and Leasing.
9. RBM Team reviews the comments, updates during "Focus Day" and asks AM to write-up exceptions if needed.
10. RBM tells DMG to make any other changes to the list.

After this process is followed and documented, as noted in Step 9, an exception is written and submitted to Central Office, Rent Bill Management Office (RBMO) requesting permission to bill the agency. The RBMO will not approve billing until we have attempted to obtain signatures from the agency for a period of 6 months. This obviously causes delays in billing that are outside of our regional control.

The Region believes that the implementation of the processes mentioned above will improve, but not necessarily eliminate, late OA activations. As noted, until Central Office changes some of the self-imposed restrictions on how we bill agencies, some late activations will occur since regional personnel are not in total control of the process (i.e. agency signatures and RBMO approval processes).

In reference to actual billing errors and mistakes on the OA that are not tied to timely activation, the region has established a tab-by-tab review process of the lease contract. The Section and Branch Chiefs are required to review the lease at multiple points in the process to ensure accuracy. We believe these additional reviews by various levels of management will improve our accuracy in all areas of the lease contract for both lessor payments and agency billing.

<u>PBS's untimely processing of lease holdovers resulted in late or missed payments to lessors</u>

Every month, both Portfolio and Leasing review the "Pre-Bill" report that is generated from the Office of Revenue in Central Office. This report identifies those assignments and leases that were active in the prior month, but expired, and will not bill or pay in the upcoming month. These assignments are then added to our "Focus Day" action list to process the holdover action in REXUS. By processing this action in REXUS, the lessor will continue to receive rent, and we will collect the revenue from the agency.

There are times when a holdover action is not appropriate, i.e. when there is a change of ownership pending near lease expiration or as a potential negotiation strategy. In July 2012, Leasing began tracking late or no payments to lessors. Beginning in October, the Leasing Division Director will be holding monthly meetings with the Section and Branch Chiefs to review expiring leases, project schedules, late lessor payments, among other things. These meetings will focus on entering information in systems timely and accurately as well as reducing the number of holdovers.

Holdovers have become more common than they should be. Partly due to some lapse in process and partly due to the restrictions noted above regarding the inability to proceed with a follow on long term lease action without an agency's signature on the OA. By holding the monthly meetings described above we will reduce the number of holdovers to only those unavoidable situations that the regional personnel do not control.

Lastly, when holdover actions are necessary, we are unable to process them in REXUS until after the expiration date. So we are not able to be proactive with our paperwork processes in those situations in which we know in advance that we do not have all of the documentation necessary to initiate billing. This is a manual process that cannot be automated given current system limitations.

PBS's improper accounting practices led to the inaccurate reporting of individual property's funds from operations

The region acknowledges the improper accounting practices referenced in the report that were related to an error in the lease profile found in the GSA financial system. While the region agrees with the findings, it should be noted that the region had identified this specific situation prior to the audit and steps had already been taken to correct the mistake. During a Lease Analysis review, the threshold analysis (discussed above) highlighted the irregularities in the revenue and expense streams and the region was able to determine the cause of the irregularities and correct the error.

The development of the lease profile includes several manual steps, which can make it prone to data entry errors. However, the region believes that this is a rare scenario among the lease inventory and is limited primarily to new lease actions in office complexes comprised of multiple facilities. Lastly, the region believes that the threshold analysis completed on the individual lease performance level, provides a quality control review to detect the occurrence of this type of data entry error.

Other Observations

This region has more than 1,500 leases, 3,500 Agency Space Assignments, and 300-400 active projects at any given time; and we do not believe that the noted observations are consistent occurrences within our inventory. However, we do value the importance of the noted observations.

We believe that the processes identified above, particularly the more frequent reviews of leases by various levels of management will further reduce the instances of errors such as those noted in Observation 1.

Of the 3 instances noted in Observation 2, two are actionable within the region. Again, the improvements to the processes noted throughout this response will reduce or eliminate these occurrences. In the third instance, the change of ownership paperwork process is one that can be time consuming due to the nature of the documents the former and new owners are required to process through the Regional Legal Counsel's office. We must stop payment to the former owner when we are notified of the sale of a building. We cannot begin rent to the new owner until this paperwork is finalized, resulting in cases in which the rent is suspended for several months.

Observations 3 and 4 are out of the control of regional personnel. Item 3 identified an instance of vacant space in a lease. We attempt to buy-out of leases when an agency terminates their assignment by giving 4 months notice when we are still in the firm term of the lease. However, lessors are not always receptive to negotiating a buyout. In those cases, we must carry the vacant space and continue to pay the lessor. This is why our fee structure carries a 2 percent indemnification fee that is charged for cancellable OAs (7% vs. 5% for non-cancellable); this additional fee helps fund lease payments for vacant space. Item 4 discusses accounting practices that affect FFO; however, we do not have any influence on these practices.

Appendix C – Report Distribution

Regional Administrator (4)

PBS Regional Commissioner (4P)

Regional Counsel (4L)

Director, Leasing Division (4PR1)

Division Director, GAO/IG Audit Response Division (H1C)

Management and Program Analyst (4PFC)

Assistant IG for Auditing (JA)

Deputy Assistant IG for Investigations (JID)

Director, Auditing Planning, Policy, and Operations Staff (JAO)