June 17, 2011

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SUBJECT: Management Advisory Report – Internal Controls Over Facility Rental Income (Report Number DA-MA-11-003)

This report presents the results of our review of the U.S. Postal Service's collection of rental income[1] (Project Number 11YR002DA000). Specifically, our objective was to assess the adequacy of internal controls over the collection of rental income. We conducted this self-initiated review based on financial risks associated with the misreporting or loss of rental income.

Facility rental income is generated by Postal Service outleases of owned property and subleases negotiated by Realty Asset Management (RAM). In fiscal year (FY) 2010, the Postal Service reported $63,593,337 in rental income for 561 leases with federal and private sector outlease and sublease tenants. This is a $2.8 million decrease over the prior fiscal year. In recent years, the Postal Service has experienced a dramatic reduction in workload resulting from advancements in technology, productivity improvements, and decreased mail volume. This workload decline has resulted in excess real estate inventory. As the Postal Service continues to optimize this excess space, effective controls over rental income will be critical to provide the capability to expand rental agreements. See Appendix A for additional information about this review.

Conclusion

Postal Service internal controls over the collection and recording of rental income need improvement. Although Postal Service real property management procedures require rental income to be recorded under the finance number of the facility outleasing or subleasing space[2] and accounting policies require general ledger accounts to be properly stated[3], we were unable to fully reconcile tenancy payments to tenant agreements. Specifically, we attempted to reconcile payments for tenant agreements

[1] Revenue associated with income payments made for occupying building space controlled by the Postal Service.
[2] *Administrative Support Manual*, Chapter 5, Facilities and Equipment, Section 517.34, Reporting Excess Space, Buildings, and Land.
[3] Handbook F-1, *Accounting and Reporting Policy*, Section 2-4.1.

between the facilities Realty Asset Management Property Outlease (RAMPO) system, St. Louis Accounting Service Center's (Accounting) outlease sublease system, and the general ledger. We were unable to reconcile payments between these systems for 10 of 30 sampled tenant agreements because:

- The accounting system did not adequately support monitoring and tracking of rental payments at the tenant/customer account level. First, many tenants remitted rental payments without including their account identification number. Second, rent payments were applied at a macro level to outstanding invoices rather than at the individual tenant/customer agreement level. Lastly, reports that would allow RAM to monitor and track payment activity at the individual tenant/customer account level did not exist.

- The roles and responsibilities of RAM and Accounting were not clearly defined relevant to the management and oversight of rental income.

- Manual processing increases the risk of errors associated with the monitoring and tracking of rental payments.

These weaknesses lessen the effectiveness of internal controls over rental income as we estimate that at least 111 of the 561 tenancy agreements held during FY 2010 contain some risk of payment error. Consequently, we estimate the Postal Service placed at least $1,532,533 in rental payments at risk for potential fraud or loss. In addition, considering the Postal Service maintains significant excess space, adequately controlling tenancy or rental transactions provides the Postal Service with an opportunity to effectively expand tenancy agreements. See Appendix B for a detailed analysis and Appendix C for an impact summary.

The U.S. Postal Service Office of Inspector General (OIG) recognizes the recent commitment of the Postal Service to improve the controls over rental income. Earlier this fiscal year, Accounting implemented an enhanced multi-step process to improve the accuracy of rental income reporting by applying payments to the correct tenancy account. While we acknowledge recent efforts, we offer the following recommendations that would further improve the controls over rental income:

We recommend the acting vice president, controller, in coordination with the vice president, Facilities:

1. Ensure tenants include account identification numbers with rent payments and develop exception reporting conducive to monitoring and tracking of payment activity at the tenant/customer account level.

2. Clarify roles and responsibilities related to the management and oversight of rental income. This should include a periodic reconciliation of Realty Asset Management Property Outlease rental payment amounts to the St. Louis Accounting Service

Center's outlease/sublease system and general ledger at the tenant/customer account level.

3. Seek opportunities to automate the monitoring and tracking of rental payments.

Management's Comments

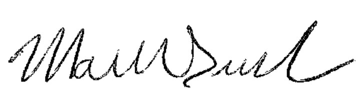
Management agreed with all of our findings and recommendations. Specifically, they stated that account identification is now achieved for lease payments and agreed to monitor and track payment activity at the tenant/customer account level on a quarterly basis beginning October 1, 2011. They will also report any exceptions, along with a monthly report of payment delinquencies to RAMPO, for follow-up action. Management agreed to document a comprehensive process flow that ASC and RAMPO will agree to by June 30, 2011, and use the reconciliation and exception and delinquency reports referenced above to keep the systems in sync. Finally, to reduce the number of manual entries and tracking, management agreed to submit a System Change Request to develop and deploy an automated data feed from RAMPO to the Outlease/Sublease System to eliminate errors and prevent redundant input. This implementation will be contingent on the Postal Service's ability to prioritize and fund the request. See Appendix D for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations and management's corrective actions should resolve the issues identified in the report.

The OIG considers all the recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Miguel Castillo, director, Engineering and Facilities, or me at 703-248-2100.



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APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The Postal Service is responsible for maintaining a system of accounting controls that provides reasonable assurance that transactions are executed and recorded in accordance with management's general or specific authorization. The checks and balances established in the various Postal Service manuals and handbooks constitute many of these internal controls. For example, Postal Service real property management procedures require rental income to be recorded under the finance number of the host facility[4] and accounting policies require general ledger accounts to be properly stated.[5] Additionally, Accounting must ensure its financial statements are prepared in accordance with generally accepted accounting principles.

RAM is responsible for the revenue generation of disposed real property that has been declared excess to operational requirements. In addition, it is RAM's responsibility to assist areas and districts in identifying properties that may be surplus to their needs.

RAM provides internal expertise to identify, analyze, and maximize the return on excess and underutilized real property assets. Some of the methods used to manage these surplus properties include:

- Outleasing: When it is not possible to dispose of surplus real property by sale, the property may be outleased. These transactions are effected in accordance with prevailing market conditions at the time of the transaction.

- Subleasing/Assignment: For surplus leasehold interests, RAM considers subleasing or assigning the lease. However, because of the risk, before subleasing or assignment is considered, Facility Service Offices make every effort to negotiate a reasonable termination arrangement with the lessor.

The Postal Service began FY 2010 with 561 outlease and sublease agreements representing 393 separate finance numbers.[6] With each new tenant, RAM completes an Outlease – Sublease Data Input form to update RAMPO records. Along with the tenant information the form contains the finance number to ensure the rental income is recorded and reported accurately. All outlease and sublease data forms are provided to Accounting. Accounting manually enters the forms into a system that produces tenant invoices and establishes rents receivable.

[4] *Administrative Support Manual*, Chapter 5, Section 517.34, Reporting Excess Space, Buildings, and Land.
[5] Handbook F-1, Section 2-4.1.
[6] RAMPO Report, dated October 1, 2009.

Accounting also sets policies and procedures through the following Postal Service publications which include governance over rental income reporting:

- Handbook F-1.
- Handbook F-23, *Accounting Policy Reference.*
- *Administrative Support Manual.*

In FY 2010, $39,666,909 (or 62 percent) of the Postal Service's rental income originated from outlease and sublease agreements with the private sector and the remaining $23,926,428 (or 38 percent) of the rental income was from government tenants, the largest being the General Services Administration (GSA).

The GSA is the nation's largest public real estate organization. It provides workspace for more than 1 million federal workers through its Public Buildings Service. Approximately half of the employees are housed in buildings owned by the federal government and half are located in separate leased properties.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to assess the adequacy of internal controls over the collection of rental income. Our scope included the review of rental income payments in FY 2010. To accomplish this, we interviewed Postal Service officials and reviewed tenancy agreements, general ledger reports, and financial documentation pertaining to rental payments. We randomly selected 30 individual tenancy agreements to review from a universe of 561 recorded in the RAMPO at the beginning of FY 2010.

We conducted this review from October 2010 through June 2011 in accordance with the Council of the Inspectors General on Integrity and Efficiency, *Quality Standards for Inspections*. We discussed our observations and conclusions with management officials on May 10, 2011, and included their comments where appropriate.

We assessed the reliability of the data by interviewing officials responsible for data entry and by reviewing lease documents, general ledger reports, and data from the RAMPO report. We identified significant data reliability issues during the course of this review; however, we deemed the actual lease agreements sufficiently reliable for the purposes of this report and used them to assess the reliability of the computer generated data.

PRIOR AUDIT COVERAGE

The OIG did not identify any prior audits or reviews related to the objective of this review.

APPENDIX B: DETAILED ANALYSIS

Inadequate Controls over Rental Income

The review identified noncompliance with policies governing rental income and significant payment integrity issues resulting in at least $1,532,533 of rental income at risk. Postal Service real property management procedures require rental income to be recorded under the finance number of the facility[7] outleasing or subleasing space and accounting policies require general ledger accounts to be properly stated.

To evaluate controls over the rental income reporting process, we randomly sampled 30 of the 561 sublease/outlease agreements. We compared the rental income for FY 2010 as documented in the lease to the following three systems:

- General Ledger – rental income reported in Accounts 44046 – Rent, Private Concerns and 44047– Rent, U.S. Government Agencies.
- Accounting's Oracle database – payment records.
- RAMPO – outlease/sublease data.

Based on the 30 tenant agreements reviewed, 10 (or 33 percent) contained significant reporting discrepancies.[8] The value at risk associated with the discrepancies was $1,532,533. Many of these records contained multiple inconsistencies resulting in infractions in more than one evaluation category. Table 1 displays general information on the types of discrepancies and the financial impact of each discrepancy on rental income.

For three of the rental agreements, Postal Service Accounting did not have the outlease/sublease notification form and, thus, were not monitoring monies due per the tenant agreement. We confirmed two of the three agreements are active. We could not determine whether the third, an antenna lease,[9] is still active. The facility maintenance manager conveyed that the antenna was still on top of the facility. The tenant/customer agreement requires removal of equipment upon termination of the lease.

[7] *Administrative Support Manual*, Chapter 5, Section 517.34, Reporting Excess Space, Buildings, and Land.
[8] Discrepancies that are greater than 3 percent of the annual lease agreement.
[9] Antenna leases provide space on building rooftops to send and receive signals for cellular phones, pagers and other voice data, and video communications.

Table 1: Lease Agreements with Reporting Discrepancies

	Host Office Name	Space Type	Discrepancy	(Under) /Over Reported
1	[redacted]	Antenna	No record of the rental agreement in the out lease and sublease system.	($13,608)
2	[redacted]	Office/Retail	Delinquent rental income payments.	($1,477,977)
3	[redacted]	Parking	Incorrect finance number used in the collection process.	($5,565)
4	[redacted]	Antenna	Unable to verify annual lease rate due to incomplete record keeping.	($3,150)
5	[redacted]	Office/Retail	Understated revenue due to tenants being billed incorrectly for the year.	($10,395)
6	[redacted]	Antenna	No record of the rental agreement in the out lease and sublease system.	($7,217)
7	[redacted]	Oil/Gas Lease	Procedural vulnerability because no record of the rental agreement is in the Accounting system due to variable payment schedule.	($119)
8	[redacted]	Antenna	Difference between tenancy agreement and Accounting system records.	($4,981)
9	[redacted] - [redacted]	Office/Retail	Delinquent rental income payments.	($9,513)
10	[redacted]	Credit Union	Overstated revenue based on rental agreement.	$8
Net Value of Discrepancies				**$1,532,533**

Ninety- seven percent (or $1.48 million) of the discrepancies related to agreements with the GSA. The GSA made bulk payments to satisfy multiple tenant/customer agreements. Because Accounting did not fully track these agreements at the individual account level, missing payments for two records in our sample were not noted until the OIG Office of Investigations notified Accounting.

We reconciled the tenant agreements for the remaining 20 records to the general ledger, Accounting (Oracle database), and RAMPO records. Discrepancies were insignificant.[10]

[10] Discrepancies that are less than 3 percent of the annual lease agreement.

We considered internal controls over rental income ineffective because:

- The accounting system did not adequately support monitoring and tracking of rental payments at the tenant/customer account level. First, many tenants remitted rental payments without including their account identification number as required by the terms of the lease agreement. Second, as a result of the GSA's lump sum payment practices, GSA rent payments were applied at a macro level to outstanding invoices rather than at the individual tenant/customer agreement level. Lastly, reports did not exist that would allow RAM to monitor and track payment activity at the individual tenant/customer account level. Accounting Data Mart reports provide rental income revenue but do not provide information at the customer account level.

- The roles and responsibilities of RAM and Accounting were not clearly defined relevant to the management and oversight of rental income. For example, RAM was responsible for managing all outlease and sublease agreements, but relied on Accounting for notification of delinquent payments. Accounting was unable to notify RAM of delinquent payments because payment activity is not tracked at the tenant/customer account level.

- RAM uses a manual process, vulnerable to human error, to track payment activity. In cases of non-payment, Accounting notifies RAM by providing a multi-page document in portable document format which RAM must scan and then take from and manually transfer applicable data to their tracking spreadsheet. In addition, due to human error, some lease agreements were not in the electronic Facility Management System or did not clearly state the annual rental income.

These weaknesses lessen the effectiveness of internal controls over rental income as we estimate that at least 111[11] of the 561 tenancy agreements held during FY 2010 contain some risk of payment error. Consequently, we estimate the Postal Service placed at least $1,532,533 in rental payments at risk for potential fraud or loss. As such, we will report this amount as other impact for having data integrity issues. In addition, considering the Postal Service maintains significant excess space, adequately controlling rental transactions provides the Postal Service an opportunity to securely expand the economic benefits of tenancy agreements.

[11] Using a simple random sample methodology, 10 of 30 tenancy agreements contained payment errors. Based on these results, we are 95 percent confident that at least 19.8 percent (111) of tenancy agreements have associated payment errors.

APPENDIX C: OTHER IMPACTS

Finding	*Impact Category*	*Amount*
Inadequate Controls over Rental Income	Revenue at Risk[12]	$1,532,533

[12] Revenue that the Postal Service is at risk of losing.

APPENDIX D: MANAGEMENT'S COMMENTS

UNITED STATES
POSTAL SERVICE

June 10, 2011

Mark W. Duda
Deputy Assistant Inspector General
for Support Operations

SUBJECT: Draft Management Advisory Report – Internal Controls Over Facility Rental Income (Report Number DA-MA-10-DRAFT)

Thank you for the opportunity to review and comment on the subject draft audit report.

Management agrees with the recommendations and has action plans detailed below to address each one.

Recommendation 1:

Ensure tenants include account identification numbers with rent payments and develop exception reporting conducive to monitoring and tracking of payment activity at the tenant/customer account level.

Response:

Account identification is now achieved for both GSA and private lease payments. For GSA, a lump sum payment is received for multiple leases. The ASC identifies the payments to specific agreements using a common sub-location code in both the GSA payment file and the Outlease/Sublease System. For private tenant leases, invoices are issued by individual sub-location code, and remittances generally are received for each individual invoice issued. Exceptions exist for two tenants (American Towers and Cingular) which pay lump sums but provide supporting detail by sub-location.

The ASC has the ability to extract key elements of each lease (e.g., lease term, lease amount) and match the items to the Outlease/Sublease System. This match will be conducted on a quarterly basis beginning October 1, 2011. Any exceptions will be sent to Realty Asset Management for resolution. In addition, a monthly report of payment delinquencies will be furnished to Realty Asset Management for follow-up action.

Recommendation 2:

Clarify roles and responsibilities related to the management and oversight of rental income. This should include a periodically reconciliation of Realty Asset Management Property Outlease rental payment amounts to the St. Louis Accounting Service Center's Outlease/Sublease system and general ledger at the tenant/customer account level.

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Response:

A comprehensive process flow is being documented that will be agreed to by the ASC and Realty Asset Management. The target date for completion is June 30, 2011. In addition the reconciliation and the exception and delinquency reports referenced above will be used to keep the systems in synch. Details, however, will not be maintained in the corporate general ledger as this system is not designed for nor intended to be the repository for this type of detailed information.

Recommendation 3:

Seek opportunities to automate the monitoring and tracking of rental payments.

Response:

Currently there are three (3) systems used to track rental income: 1) Realty Asset Management Property Outlease (RAMPO) a sub-system in eFMS, 2) a legacy system referred to as Outlease/Sublease System (OS), and 3) Oracle Accounts Receivable. Although the latter two systems are linked, the first two systems are not.

To reduce the number of manual entries and tracking we will submit a System Change Request (SCR) to develop and deploy an automated data feed from RAMPO to the Outlease/Sublease System in order to eliminate errors and prevent redundant input. An exception/edit report will be generated for follow-up action of any leases for which the auto-feed fails. Implementation is contingent on the Postal Service's ability to prioritize and fund the request.

We do not believe that this report contains any propriety or business information and may be disclosed pursuant to the Freedom of Information Act.

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