



**CITY OF COLORADO SPRINGS
OFFICE OF THE CITY AUDITOR**

**06-165 – REAL ESTATE SERVICES
PERFORMANCE AUDIT**

OCTOBER 6, 2006

Public Report

Jeff Litchfield, CPA CIA CFE
City Auditor

Denny Nester, CPA CIA
Assistant City Auditor





Office of the City Auditor

Date: October 6, 2006
To: Honorable Mayor and Members of City Council
Re: 06-165 – Real Estate Services Performance Audit

We have completed a performance audit of the Real Estate Services Division of the City of Colorado Springs.

As background information, in our audit report 06-280a – Jimmy Camp Creek Property Purchases, issued on August 11, 2006, we reported a finding that directly related to the Real Estate Services Office (RES). That finding is reproduced in this audit report as finding 3.

The purpose of this audit was to evaluate whether RES was; 1) in compliance with policies and regulations, 2) operating in the most economical, efficient and effective manner, and 3) safeguarding City assets and property.

As always, please let me know if you have any questions.

Sincerely,

A handwritten signature in purple ink that reads "Jeff Litchfield".

Jeff Litchfield
City Auditor

Cc: Lorne Kramer, City Manager
Mike Anderson, Assistant City Manager
Ron Cousar, Director, Internal Support Services
Darlene Kennedy, Real Estate Services Manager

CITY AUDITOR JEFF LITCHFIELD, CPA CIA CFE

TEL 719-385-5991 • FAX 719-385-5699 • FRAUD HOTLINE 719-385-2387
30 South Nevada Avenue, Suite 604 • P.O. Box 1575, Mail Code 640 • Colorado Springs, CO 80901-1575

Table of Contents

06-165 – Real Estate Services Performance Audit

	Page
Introduction	
Authorization	2
Organization Placement	2
Scope and Methodology	3
Background	3
Overall Conclusion	3
Findings, Recommendations and Responses	
Department Structure Related	4
Internal Control Related	7

Introduction

AUTHORIZATION

We performed an audit of the City of Colorado Springs Real Estate Services Office (RES). We conducted this audit under the authority of Chapter 1, Article 2, Part 7 of the Colorado Springs City Code, and more specifically parts 703, 705 and 706, which state:

1.2.703: ENSURE PUBLIC ACCOUNTABILITY:

The City Auditor shall ensure that administrative officials are held publicly accountable for their use of public funds and the other resources at their disposal. The City Auditor shall investigate whether or not laws are being administered in the public interest, determine if there have been abuses of discretion, arbitrary actions or errors of judgment, and shall encourage diligence on the part of administrative officials. (1968 Code §1-10.3; Ord. 76-54; 1980 Code; Ord. 01-42)

1.2.705: DETERMINE EFFECTIVENESS AND EFFICIENCY OF PROGRAMS:

The City Auditor shall determine the extent to which legislative policies are being efficiently and effectively implemented by administrative officials. The City Auditor shall determine whether City programs are achieving desired objectives. The City Auditor shall review the administrative control systems established by the enterprises, department or group managers and by the City Manager, Utilities Executive Director and Memorial Hospital Executive Director and determine whether these control systems are adequate and effective in accomplishing their objectives. (1968 Code §1-10.3; Ord. 76-54; Ord. 01-42)

1.2.706: EXAMINE BOOKS, RECORDS:

The City Auditor shall examine and inspect all books, records, files, papers, documents and information stored on computer records or in other files or records relating to all financial affairs of every office, department, group, enterprise, political subdivision and organization which receives funds from the City or under the direct or indirect control of the City Council. The Auditor may require any person to appear at any time upon proper notice and to produce any accounts, books, records, files and other papers pertaining to the receipt or expenditure of City funds, whether general or special. If that person fails to produce the papers, then the Auditor may request Council approval to search for and take any book, paper or record in the custody of that person or public official. (1968 Code §1-10.3; Ord. 76-54; Ord. 01-42)

ORGANIZATION PLACEMENT

The City Auditor's Office of the City of Colorado Springs is structured in a manner to provide organizational independence from the entities it audits. This is accomplished by the City Auditor being appointed by and reporting directly to the City Council. The audited entity in this audit was RES, which is under the purview of the City Manager. The City Manager is a City Council Appointee.

Introduction

SCOPE AND METHODOLOGY

We conducted our audit in a manner that meets or exceeds the Standards for the Professional Practice of Internal Auditing, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors. Our audit included such tests of records and other supporting documentation as we deemed necessary in the circumstances. We reviewed the internal control structure and compliance tests were performed. Sufficient competent evidential matter was gathered to support our conclusions.

The purpose of this audit was to evaluate whether RES was; 1) in compliance with policies and regulations, 2) operating in the most economical, efficient and effective manner, and 3) safeguarding City assets and property. Our audit period was calendar year 2005.

BACKGROUND

RES is a unit within Internal Support Services. Their mission is to provide real estate and support services, including acquisition, disposition, relocation, management and leasing services to all City departments and City enterprises; provide information to the City and its citizens; and protect and conserve City assets and property.

OVERALL CONCLUSION

We conclude there are several areas where RES could be improved. The biggest issue facing RES was defining their role within the City and its entities. Based on our review, we identified seven findings in two general areas: Department Structure Related and Internal Control Related. One finding was previously reported in audit 06-280a - Jimmy Camp Creek Property Purchases. That finding is reproduced in this report as Finding 3.

For the findings that follow, we have made no determination as to which findings are more important than others. Therefore, the findings are not listed in order of importance.

Findings, Recommendations and Responses

DEPARTMENT STRUCTURE CONCERNS:

1. The role of Real Estate Services was not clear.

It appeared that over time, the role of RES had been diminished and many activities were being handled at the department level. RES was not involved in many real estate transactions, including lease agreements and executive agreements. RES staff didn't always get the cooperation from departments that they should. RES was also limited to the amount of services that could be provided based on their staffing level.

Real estate knowledge is a specialized field. Criteria needs to be established so that all City departments and enterprises are aware of what transactions need to go through RES and what transactions can be handled by the departments with limited assistance from RES. The City is exposed to risk and liability if real estate transactions aren't handled appropriately.

Auditor's Recommendation:

We recommend that management re-evaluate the role of RES to determine what their future role should be. Some areas that should be considered are:

1. RES needs to be given the authority they need to provide the services that management requires.
2. Increase the staff or outsource more responsibilities. RES needs to be given the staff to support the work they are being asked to do. If management decides not to increase the size of the staff, then policies should be established to determine what services should be contracted out.
3. What real estate activity should be handled by RES and what should requesting departments handle?
4. Where should real estate documents be kept? There should be a complete listing of all real estate property owned by the City, all leases entered into by a City entity, and all executive agreements regarding real estate.
5. Who is responsible for administering and monitoring the terms of lease agreements?

City Response:

- Management is in support of the Real Estate Services office. The City's administration has given Real Estate Services authority to accomplish their mission. The role and responsibilities of the Real Estate Services Office has been communicated to the departments. The role of the Real Estate Services office is to work in conjunction with the departments to accomplish all real estate transactions.

Findings, Recommendations and Responses

- In order to accomplish its tasks, the Real Estate Services office has streamlined its functions by creating standard operating procedures and form templates. From time to time there is a need to hire an expert to accomplish tasks such as the need to relocate families/businesses or obtain professional appraisals. Real Estate Services has the flexibility to hire outside consultants to complete real estate transactions that cannot be accomplished in-house.
- The Real Estate Services office and the departments work together to accomplish the requested real estate transactions. The Real Estate Services office staff should oversee all real estate transactions processed by the City. The Real Estate Services office assists the departments with technical advice, oversees real estate functions, and assures that real estate transactions are accomplished in a timely and proficient manner.
- Real estate documents should be kept in close proximity to the Real Estate Services office. The office staff accesses the files daily. There should be a complete inventory of all City owned property rights, to include easements and fee simple property ownership. Real Estate Services acknowledges that this area needs improvement and has begun to correct this situation by utilizing a new data base and program for data entry.
- Leases are specific to a department's needs and budgetary issues. Real Estate Services should assist departments to assure that lease forms are standard and terms and conditions are acceptable. The Real Estate Services office will maintain a copy of all leases for monitoring purposes. Real Estate Services in conjunction with the City Attorney's office is working on a standard lease template to be used by all City departments. The City Attorney's office will review all lease documents before they are executed.

Findings, Recommendations and Responses

2. Real Estate Attorney

The efficiency and consistency of legal assistance could be improved by designating one attorney as the lead attorney for real estate activities. Since many real estate activities had been performed by the department that requested the transaction, the attorney assigned to the requesting department was the attorney who handled real estate questions and concerns.

Real estate law is a specialized area with which most attorneys may be familiar, but not all attorneys have developed expertise. Therefore, it may be more efficient and effective for the City if real estate issues were coordinated by an attorney with expertise in real estate. Real estate policies and procedures would also be applied more consistently if all of the City's attorneys could rely on one lead attorney as their primary resource for real estate questions.

Auditor's Recommendation:

We recommend that one attorney be designated as the lead real estate attorney. This attorney would be a resource for all attorneys that work with departments in the City, Utilities and Memorial Hospital. The City might also want to consider whether it would be beneficial to add a real estate paralegal to the Real Estate Services staff.

City Response:

The City Attorney has appointed the Deputy City Attorney-Municipal as the single point contact to coordinate legal services for the Real Estate Services Office.

Findings, Recommendations and Responses

INTERNAL CONTROL RELATED CONCERNS:

3. The Handbook for Acquisition of Real Property needed to be updated and strengthened.

Note – The following finding was included in audit 06-280a – Jimmy Camp Creek Property Purchases, which was published August 11, 2006. Because of its direct bearing on the Real Estate Office, it is being reproduced.

Applicability of the Handbook

The City Council, though their *Rules and Procedures of City Council*, had recognized the need to follow specific steps when purchasing property. In Part 6 of that document, they adopted the Handbook for Land Acquisition (the Handbook, also referred to as the Handbook for the Acquisition of Real Property) and also indicated that matters involving Utilities' land acquisitions are subject to Utility Board policies or by-laws.

In our review of the Handbook and its use, we found several references to its use as a "guideline."

Colorado Springs Utilities, through its Utilities Administrative Regulations, had stated the real property acquisition process shall follow the provisions of the "Handbook." The Utilities Administrative Regulations also stated "the policies and requirements of this Handbook are intended only as general guidelines for the internal use of the Real Estate Services Office."

The theme of using the Handbook as a guideline is further emphasized in the Handbook itself, where in section 1-4 we find the following:

The policies and requirements of this Handbook are ***general guidelines***. As used in the Handbook, the terms "may" and "should" denote ***optional and advisory provisions***. For the purposes of determining whether negotiations have been conducted in good faith in the event of court action, it shall be necessary only to show ***substantial compliance*** with the procedures set forth in this Handbook. (emphasis added)

The first two sentences hinder our ability to determine compliance with the Handbook for any deviation would fall under the "***guidelines***" and "***optional and advisory provisions***." However, the third sentence, by containing the words "***substantial compliance***," does provide an indication that the essence of the Handbook should be followed.

Additionally, in reviewing the contents of the Handbook, we interpret it to read that property appraisals are only necessary for purchases made through a "Taking" (eminent domain) and are optional for all other purchases.

The use of the Handbook for Real Estate Acquisitions should be strengthened by defining which areas are absolutes and which are optional.

Findings, Recommendations and Responses

Ambiguity and/or Internal Conflicts within the Handbook

In our review, we found several areas where the Handbook was unclear on items we felt should be very specific. An example of an ambiguity and/or an internal conflict within the document is as follows.

The Handbook contains the following wording in Chapter 3 – Determining Fair Market Value:

- 3.8 **ESTABLISHMENT OF JUST COMPENSATION**
- a. The Real Estate Services Manager shall certify documentation which:
 - 1. Establishes just compensation (fair market value) for each property.
 - 2. Identifies each property by name of owner, parcel number, or other identification.
 - 3. Describes and delimits the property and the interest to be acquired therein.
 - 4. Certifies that the establishment of fair market value with respect to each property has been performed in a competent manner.
 - b. In cases where fair market value is determined to be \$100,000 or more, just compensation shall be established by the City Council.
 - c. In cases where fair market value is determined to be less than \$100,000, just compensation shall be established by the Real Estate Manager, in coordination with the requesting department.

In reading this section, it leaves us with the impression the City Council should be involved in cases where the fair market value is greater than \$100,000. However, in the definition section of the Handbook, we find the following:

Just Compensation – The amount established by City Council or by the Real Estate Services Office in cooperation with the requesting department, to justly compensate the owner considering fair market value of the property. (City Council establishes just compensation for properties to be taken with a fair market value over \$100,000. The Real Estate Services Office in cooperation with the requesting department establishes just compensation for properties to be taken with a fair market value under \$100,000.)

In reading the definition of Just Compensation, we find a reference in parentheses that indicates Council is only involved for properties “to be taken” with a value greater than \$100,000. Property to be “taken,” while not defined in the Handbook, is generally believed to mean property obtained through an eminent domain proceeding.

The Handbook should be clearer concerning when City Council would be involved in establishing or affirming fair market values.

Findings, Recommendations and Responses

Documentation Retention needs to be clarified in the Handbook

Chapter 6 of the Handbook covers Documents to be retained in the parcel files. It reads:

6-1. MAINTENANCE OF RECORDS.

The Real Estate Services Manager shall maintain all records, reports, ordinances and resolutions concerning the City's OR UTILITIES' land acquisition activities after the project is completed. A record in summary form shall be kept showing major actions and items of information on each parcel as follows:

- a. Date of notice of intent to acquire.
- b. Appraisal report value and applicable dates.
- c. Amount approved as just compensation and date of approval.
- d. Date of initiation of negotiations.
- e. Date of final acceptance of offer.
- f. Date the condemnation proceeding was authorized by City Council.
- g. Date that condemnation proceeding was instituted.
- h. Date that title vests in City or Utilities.
- i. Acquisition price, if by purchase or stipulation.
- j. Acquisition price, if by court award after trial of the issue of value.

During our review, we were interested in reviewing items such as the Records of Negotiations as described in section 4-27 of the Handbook, but found that the Records of Negotiations were not available since they were not required to be kept.

Items such as documentation of negotiations are important and should be maintained in the acquisition file.

Incomplete areas of the Handbook

We found the Handbook does not address Relocation Expenses.

Relocation Expenses are usually associated with property acquisitions and, therefore, should be addressed in the Handbook.

Auditor's Recommendation:

We recommend the Handbook be updated for these and any other deficiencies. We recognize staff is currently embarked on a project to achieve this recommendation and our audit report on the performance of Real Estate Services will provide additional recommendations.

Findings, Recommendations and Responses

City Response:

Real Estate Services (RES) in conjunction with the City Attorney's office is currently working on a complete revision and rewrite of the Handbook for the Acquisition of Real Property ("Handbook"). RES and the City Attorney's Office have been working on necessary comprehensive revisions to the Handbook since early 2006. The project is to be completed in the third quarter of 2007. RES acknowledges that the Handbook is vague, outdated, and incomplete. The outline for the revised Handbook is extensive; the following are some of the areas that are being addressed:

- Relocation
- Acquisition
 - fair market value
 - just compensation
 - arms length transactions
 - eminent domain
 - possession and use agreements
 - federally-funded projects
 - donations
 - required City Council action
 - Environmental Audits
- Swaps/Land Exchanges
- Disposition (property surplus)
 - required City Council action
 - Deed Disclaimers
- Appraisers/Appraisals
- Property Leases
- Easement Vacations
- Easement Encroachments
- Revocable Licenses/Leases
- Dedication/Acceptance by Plat
- Intra-City property transfers
- Appeal Process
- File maintenance and archiving
- Real property interest inventory system
- Definitions

The verbiage in the Handbook will be revised to eliminate vague terms such as "guidelines" "may" and "should" when not applicable. The revised Handbook will clearly address actions which may be optional and actions which should be definite.

The major areas of concern: relocation, acquisition, and disposal will be addressed this year. RES and the City Attorney's office estimate that the revised Handbook will be completed in 2007.

Findings, Recommendations and Responses

4. Written policies and procedures had not been established for the Real Estate Services Department.

To design, implement and maintain an internal control structure, an organization must have extensive documentation. This documentation includes a policies and procedures manual along with related documents. Policies and procedures are designed to provide management with reasonable assurance that the goals and objective it believes important will be met.

Auditor's Recommendation:

We recommend that policies and procedures be established for RES.

City Response:

- The Real Estate Services office has initiated a program to establish standard operating procedures for all functions performed by the Real Estate Services office. Real Estate Services will have the standard operating procedures for essential functions completed by the end of 2006.
- The Real Estate Services office has also initiated a program to establish approved form templates to be used for all real estate services.

Findings, Recommendations and Responses

5. No policies or procedures had been established for leases. The City did not have a standard lease agreement to be used for a routine lease.

There were no standard lease documents. RES was not always involved in the lease process. The City Attorney's Office reviewed leases only "as to form." No leases were stored in RES.

Standard policies and procedures should be in place to guide lease activity. A standard lease document should contain all the relevant lease language necessary to protect the City. RES should be involved in lease transactions to ensure that the lease documents are complete and to provide guidance to City departments/entities. RES should also maintain copies of all City leases.

Auditor's Recommendation:

We recommend that a standard lease be developed. We also recommend that RES be involved in lease transactions and RES maintain a copy of all leases. RES should work with departments to obtain copies of all current leases. Lease policies and procedures should be prepared. The policies and procedures should also address how the leases will be administered and monitored.

City Response:

- The Real Estate Services Office in conjunction with the City Attorney's office will complete a lease template that will be used by all City departments. The lease template is scheduled to be completed by December 2006. The City Attorney's office will be reviewing and approving all lease documents before they are executed. The revised Real Estate Handbook will address policies and procedures for leases.

Findings, Recommendations and Responses

6. An escrow account should be established for all earnest money received in real estate activities.

Earnest money received was deposited into the department's account responsible for the real estate transaction.

Escrow bank accounts are unique "accounting entities" which are separate in purpose and function from the other accounts. The use of a separate escrow account provides greater protection against possible "illegal commingling of funds" and potential misuse of funds.

Auditor's Recommendation:

We recommend that a separate account be established for earnest money deposits and that account be controlled by RES.

City Response:

- The Real Estate Services office has worked with the Accounting and Payroll manager to set up an escrow account. The escrow account is established as an "Escrow Liability Account" and will be held within the Accounts Payable Department. The Accounts Payable Department will assure that proper control of funds is maintained.

Findings, Recommendations and Responses

7. Real estate documents were not kept in a secure, fire safe location.

The RES file room did not provide adequate protection of documents.

In the past, the City Clerk kept real estate documents. Prior RES management made the decision to keep all real estate documents in RES or in the related departments. The City could experience a loss of assets if documents were lost, stolen or destroyed.

Auditor's Recommendation:

We recommend that the City Clerk keep documents identified by RES.

City Response:

- Real estate documents are kept in a non-secure room located in the Real Estate Office area on the seventh floor of the City Administration Building. Facilities Management was asked to inspect the file room and supply a report. Facilities Management has supplied Real Estate Services with several options that are currently being studied.
- It is essential that staff has access to the real estate files to accomplish their daily work.
- The existing real estate documents have been scanned and can now be accessed electronically. The ability to access the scanned documents allows staff to send the documents over the internet.
- Water and mineral rights certificates have been transferred to the City Clerk's vault for safe keeping.