Office of Inspector General

OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDITS

DATE: August 25, 2000

TO: Arleas Upton Kea
Director, Division of Administration

FROM: Sharon M. Smith
Assistant Inspector General

SUBJECT: Audit of *Pacific Place Lease Agreement*
(Audit Report No. 00-037)

This report presents the results of the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General's (OIG) audit of the Pacific Place lease agreement in Dallas, Texas. We initiated this audit as a follow-on to our audit of the Pacific Place renovation project (Audit Report No. 00-023, *Pacific Place Renovation Project*, dated June 26, 2000). Generally, we found that the landlord was complying with the lease agreement. However, we questioned $17,602 for overcharges resulting from miscalculations of guard services billings. In addition, we believe future leases should be more specific as to security guard coverage to be provided by the landlord.

BACKGROUND

On September 11, 1997, the FDIC entered into a lease agreement with the 1910 PP Limited Partnership (landlord) for the use of 295,146 square feet of office space in the Pacific Place building in downtown Dallas, Texas. The lease commencement date was December 1, 1997 with a 10-year term expiring November 30, 2007. Since December 1997, the FDIC has increased its leased space to 304,674 square feet. According to the lease agreement, the FDIC's base rent per square foot was $12.13 for years 1 and 2, $13.63 for years 3 through 5, $14.63 for years 6 through 8, and $15.63 for years 9 and 10.

The building's operating expenses, such as fire protection, ventilation systems, security, and other services are paid by the landlord. However, the FDIC pays for its share of operating expense increases over the 1998 base year's expenses. The landlord billed the FDIC $6,093 for 1999's operating expense increases over the 1998 base year.

In addition, the landlord bills the FDIC for additional goods and services furnished but not provided for by the lease. These additional goods and services are referred to as "Special Billings." These expenses include such items as additional security service required by the FDIC; tenant leasehold improvements; after-hours heating, ventilation, and air-conditioning; additional cleaning; and restroom supplies over and above the building standard. The landlord pays the vendor directly and bills the FDIC the same expense plus a 10-percent administrative fee. For 1998 and 1999, the FDIC paid Special Billings totaling $1,052,340 and $707,446, respectively.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine whether (1) the landlord was complying with the lease agreement and (2) lease expenses were reasonable, adequately supported and allowable under the lease terms and conditions. Our work included a review of the lease agreement and its amendments, operating expenses, and lease-related expenses incurred locally and billed to the FDIC by the landlord as Special Billings.

To accomplish our objectives, we interviewed personnel from the Division of Administration's (DOA) Dallas and Washington Corporate Services Branches. Also, we reviewed base year (1998) operating expenses, 1999 operating expense increases, and lease-related expenses for 1998 and 1999. Base year operating expenses for 1998 totaled $2,027,371. Our testing of base year operating expenses covered $1,339,153, which included $408,054 in real estate taxes. Specifically, we:

- compared the amounts claimed with vendor invoices and/or other supporting documentation,
- compared the types of operating expenses claimed with the types the lease authorized, and
- traced the operating expenses to the landlord's general ledger.

Our review of the 1999 operating expense increases showed they were not material ($0.02 per square foot or $6,093) so we did not test the 1999 operating expenses.

We also reviewed the landlord's Special Billings for calendar years 1998 and 1999. These expenses represented items such as day maid and porter service, miscellaneous construction of leasehold improvements, building repairs, and additional guard services. For 1998 these expenses totaled $1,052,340 of which we tested $355,902. For 1999 these expenses totaled $707,446, of which we tested $220,183. Specifically, for both years, we:

- interviewed Washington and Dallas DOA personnel regarding the allowability of these expenses,
- compared the types of expenses with the types authorized by the lease,
- compared the lease-related expenses with those claimed under operating expenses to determine if there were duplications,
- reviewed payment authorization vouchers, accompanying invoices and other supporting documents, and
- compared leasehold improvements paid for under the lease with improvements paid for under the recent Pacific Place renovation project.

Because the lease was not specific as to the security guard services the landlord was required to provide, we reviewed security guard expenses incurred both under the lease and those billed as Special Billings by the landlord. We reviewed these expenses from the inception of the lease, December 1, 1997 through April 1, 2000, which totaled $365,967 for security guard expenses covered by the lease and $770,712 for additional security guard expenses paid as Special Billings.

To determine if the security guard expenses were reasonable, adequately supported, and complied with the terms and conditions of the lease agreement, we:

- reviewed sections of the lease agreement outlining requirements for the landlord,
- reviewed and tested for mathematical accuracy the work orders showing security billings, and
- compared the number of security guard hours claimed under the lease as operating expenses with the number of hours the FDIC paid relating to Special Billings.

We did not review internal controls for either the FDIC or the landlord, because we concluded that the audit objectives could be met more efficiently by conducting substantive tests rather than placing reliance on their respective internal control systems. Accordingly, we do not express an opinion on internal controls. We conducted the audit from January 4, 2000 through June 7, 2000 in accordance with generally accepted government auditing standards. We performed our work primarily within DOA's Acquisition and Corporate Services Branches in Dallas, Texas and Washington, D.C., and West World Management, the parent company of the landlord's 1910 PP Limited Partnership, in Purchase, New York.

RESULTS OF AUDIT

Generally, the landlord was complying with the lease agreement. Our testing of operating expenses and Special Billings indicated that for the items reviewed, except for guard services, the landlord's billings were adequately supported, allowable, and in accordance with the contract terms. However, Special Billing calculation errors for guard services resulted in the FDIC paying the landlord $17,602 too much for the hours billed. Further, we believe the lease agreement was not as specific as it should have been in detailing guard services the landlord was to provide.

THE LANDLORD BILLED THE FDIC TOO MUCH FOR GUARD SERVICES

For the period October 17, 1999 through April 1, 2000, the landlord charged the FDIC $17,602 too much in Special Billings for guard services because of a calculation error. Specifically, the invoiced labor hours multiplied by the labor rates resulted in products less than the products shown on the invoices. According to Dallas DOA personnel, the errors resulted from a change in the billing software used by the guard services contractor who has since corrected the problem. We brought this matter to DOA personnel's attention on March 16, 2000; DOA personnel told us that they contacted the landlord in April 2000, and the landlord agreed to deduct the overcharges from its future billings.

THE LEASE AGREEMENT WAS NOT SPECIFIC AS TO GUARD SERVICES TO BE PROVIDED BY THE LANDLORD

The lease agreement is not specific regarding the security guard coverage that the landlord is required to provide the FDIC. For example, Section 9.6 of the lease agreement states: "Landlord shall provide first-class security, comparable to that provided by other Class A buildings in the downtown Dallas area, twenty-four (24) hours a day every day of the year, including, without limitation, (i) security personnel at the Building, with at least one person in the lobby, twenty-four (24) hours a day every day of the year . . ." (Emphasis added.) We believe that "without limitation" means not limited to, "personnel" connotes more than one individual, and "at least one" means one or more. In addition, Exhibit F of the lease agreement details four locations for security guard desks, which could indicate that guard coverage was expected. Further, wording such as "at least" and "without limitation" seems to leave the amount of coverage up to the landlord who, in this instance, chose the minimum required by the lease agreement.

We asked DOA's Assistant Director for Leasing to specify for us the amount of guard service the lease agreement requires the landlord to provide. The Assistant Director submitted the question to FDIC Legal Division personnel who opined that the landlord was required to provide only one person in the lobby 24 hours a day, 7 days a week. Because the agreement does not clearly specify the amount of security guard coverage to be provided and because of FDIC Legal Division's interpretation, we could not conclude that the landlord should be providing more than one person in the lobby 24 hours a day, 7 days a week, even though the FDIC pays for 408 additional guard hours per week. From the inception of the lease through April 1, 2000, the FDIC has paid $770,712 for additional guard services (excluding extra guard services required for special events such as visits by the Chairman, etc.) We believe that in any contractual document, the FDIC's contract should explicitly state what the FDIC expects to receive for what it spends. In this case, we believe the FDIC should have specified in the contract the number of guard hours and coverage locations the landlord was to provide. DOA and FDIC Legal Division personnel agreed that the wording in future leases should be more specific.

Recommendations

We recommend that the Associate Director, Acquisition and Corporate Services Branch, DOA,

(1) Disallow the $17,602 in miscalculated guard service costs (questioned cost of $17,602, all of which is unsupported).

(2) Specify in all future leases the number of guard hours and coverage locations the landlord is to provide.

CORPORATION COMMENTS AND OIG EVALUATION

On August 16, 2000, the Director, Division of Administration (DOA), provided a written response to the draft report. The response is presented in Appendix I of this report.

The Director, DOA, agreed with our recommendations to disallow questioned costs of $17,602 related to the miscalculated guard service costs. DOA stated that ACSB Dallas already recovered this money by having the landlord credit FDIC for it on its June 2000 invoice. They also agreed to work with the Legal Division to modify the FDIC standard lease to incorporate more specific requirements for the number of hours and coverage locations that landlords are to provide guard services. DOA stated that this will be accomplished by September 30, 2000.

The Corporation’s response to the draft report provided us with the requisite elements of a management decision for both recommendations. Therefore, no further response to this report is necessary. Appendix II presents management’s proposed action on our recommendations and shows that there is a management decision for each recommendation in this report.

Based on the audit work, the OIG will report questioned costs of $17,602 (all which is unsupported) in its *Semiannual Report to the Congress*.

FDIC
Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429

Division of Administration

August 16, 2000

MEMORANDUM TO: Sharon M. Smith
Assistant Inspector General

FROM: Arleas Upton Kea *Arleas Upton Kea*
Director, Division of Administration

SUBJECT: Management Response to Draft Report: *Pacific Place Lease Agreement*

The Acquisition and Corporate Services Branch (ACSB) has completed its review of the subject Office of Inspector General (OIG) draft report. The OIG identified two findings with two recommendations, including $17,602 in questioned costs. Based on our preliminary review, one of the corrective actions has been completed; the other will be accomplished in the future according to the timetable in Exhibit A. Exhibit A summarizes the audit findings and recommendations and provides expected completion dates and the documentation that will confirm completion.

Management Decision:

Finding #1: The Landlord Billed the FDIC too Much for Guard Services

Recommendation #1: Disallow the $17,602 in miscalculated guard service costs.

Management Response #1: We agree with the recommendation. ACSB Dallas already recovered this money by having the landlord credit FDIC for it on its June 2000 invoice.

Finding #2: The Lease Agreement was not Specific as to Guard Services to be Provided by the Landlord

Recommendation #2: Specify in all future leases the number of guard hours and coverage locations the landlord is to provide.

Management Response #2: We agree with the recommendation. DOA will work with Legal to modify the FDIC standard lease to incorporate more specific requirements.

If you have any questions regarding the response, you may contact Andrew O. Nickle, Audit Liaison for the Division of Administration at (202) 942-3190.

Attachment

cc: Howard Furner
Andrew Nickle
Mary Rann

EXHIBIT A

SUMMARY OF ACQUISITION AND CORPORATE SERVICES BRANCH MANAGEMENT DECISIONS

NO.	FINDING DESCRIPTION	QUESTIONED COST/OTHER FINANCIAL ADUSTMENT	MANAGE-MENT RESPONSE	DESCRIPTION OF CORRECTIVE ACTION	EXPECTED COMPLETION DATE	DOCUMENT VERIFYING COMPLETION
1	The Landlord Billed the FDIC too Much for Guard Services	**$17,602**	**Agree**	**CORRECTIVE ACTION FOR REC #1:** FDIC has already recovered this money by having the Landlord credit FDIC that amount on its June 2000 invoice.	completed	June 2000 Invoice
2	The Lease Agreement was not Specific as to Guard Services to be Provided by the Landlord	**$0**	**Agree**	**CORRECTIVE ACTION FOR REC #2:** ACSB will work with Legal to modify the FDIC standard lease to incorporate more specific requirements.	Sept 30, 2000	Revised FDIC standard lease agreement section

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MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid. Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	Disallow the $17,602 in miscalculated guard service costs (questioned cost of $17,602, all of which is unsupported).	Completed	June 2000 Invoice	$17,602 in disallowed costs	Yes
2	Specify in all future leases the number of guard hours and coverage locations the landlord is to provide.	September 30, 2000	Revised FDIC standard lease agreement section	None	Yes