New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor

Department of the Treasury
Division of Property Management and Construction

July 1, 1998 to April 14, 2000

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State Auditor
The Honorable Christine Todd Whitman  
Governor of New Jersey

The Honorable Donald T. DiFrancesco  
President of the Senate

The Honorable Jack Collins  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of the Treasury, Division of Property Management and Construction for the period July 1, 1998 to April 14, 2000.

If you would like a personal briefing, please call me at (609) 292-3700.
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Department of the Treasury  
Division of Property Management and Construction

**Scope**

We have completed an audit of the Department of the Treasury, Division of Property Management and Construction for the period July 1, 1998 to April 14, 2000. This audit was limited to the property management segment of the division which administers the state’s leasing program at an annual expenditure of $174 million.

**Objectives**

The objectives of our audit were to determine whether financial transactions were related to the accounts under review, were reasonable and were recorded properly in the accounting systems. We also tested for resolution of significant conditions noted in our prior report.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

**Methodology**

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed agency personnel to obtain an understanding of the programs and the internal control.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample transactions were judgmentally selected.
To ascertain the status of findings included in our prior report, we identified corrective action, if any, taken by the agency and walked through the system to determine if the corrective action was effective.

Conclusions

We found that the financial transactions included in our testing were related to the accounts under review, were reasonable and were recorded properly in the accounting systems. In making this determination, we noted certain internal control weaknesses and a matter of compliance with laws and regulations meriting management’s attention. We also found that the agency has resolved the significant issues noted in our prior report.
The division should conduct periodic visits to leased property sites to ensure proper utilization of space.

Space Utilization

The Division of Property Management and Construction (DPMC) does not conduct periodic visits to leased property sites as required by N.J.A.C., 17:11-2.6. In addition, N.J.A.C. 17:11-3.1 states “by October 1st of each year, all state agencies including, but not limited to, those in charge of their own real estate, should verify and report to the DPMC the capacity and utilization of all space owned, leased, and subleased”. Furthermore, the state agencies are to report employee position information for each leased site for the current and subsequent fiscal year in the format prescribed by the DPMC. Currently, there is no format for state agencies to submit to the DPMC the information requested. An automated Space Planning Request (SPR) was created on Info Bank, part of the state’s automated computer system, so the agencies could annually complete the SPR on-line and send it to the DPMC. The system was cumbersome and eventually was not utilized.

We conducted visits to 15 leased facilities of the 353 facilities under the control of the DPMC to evaluate the utilization of the leased space. Space was underutilized at one location. According to the original SPR, 53 employees were to occupy the leased facility. During the field visit, management of the leased facility stated that the highest occupancy rate of the building was 33. Currently, there are 20 employees located at this site. We estimate that $478,000 could have been saved since the lease inception 12 years ago if a smaller facility was leased.

Recommendation

We recommend the DPMC institute a usable reporting format. They should also conduct periodic site visits.

Auditee’s Response

The DPMC has developed a uniform checklist, which will be utilized to capture information regarding the utilization of leased space. To bolster this effort, the division is in the process of assigning a
full time staff member to conduct routine inspections at all of these facilities. This effort will permit more systematic inspections and will ensure that utilization is maintained consistent with lease agreements.

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**Escalations**

An escalation is an upward adjustment based on an increase in specified factors identified in the lease contract. These factors usually pertain to such items as taxes, operating expenses, and utility expenses. The state acknowledges increases may occur and agrees to pay a pro rata share of these costs based upon the percentage of occupancy of the building. Currently, there are 353 active leases and most contain escalation language. Fiscal year 1999 escalation payments totaled $11 million.

Our review of the escalation payment process disclosed escalation requests were being reviewed and adjusted where appropriate. There are, however, no formal written policies or procedures for this area. The division relies on one person who is responsible for receiving the escalation information, reviewing the documentation, and preparing summary sheets breaking down the reimbursable escalation costs associated with each lease. Currently, there are 81 escalation packages that have not been reviewed totaling $1.8 million.

**Recommendation**

We recommend that the division address the control weakness resulting from lack of written policies and procedures and from having one individual audit all escalation claims submitted. The division should also take the steps needed to reduce the backlog of unprocessed escalation packages.

**Auditee’s Response**

The unit is in the process of writing a policy and procedure concerning the receipt and processing of escalation payments. Also, internal control measures have been taken whereby all payments are now
reviewed and certified by a supervisor other than the analyst preparing the escalation payment for processing. This procedure will be formally incorporated into the new policy. Finally, the DPMC has hired an additional staff person to assist with the analysis and review of escalation payments. This initiative has already resulted in the reduction of lease escalation packages awaiting processing by 50 percent.

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MONTH-TO-MONTH LEASES

Month-to-month leases are expired term leases that are in some phase of the lease renewal process. Occasionally, month-to-month leases cannot be avoided due to agencies’ uncertainty about future program needs, delays in preparation of new sites, or agencies anticipating new program initiatives which are subsequently not funded. The objective of the DPMC for continuing leases on a month-to-month basis is to continue to provide state agencies with a work environment until a new term lease is negotiated. As of October 1994, there were 237 leases on a month-to-month basis. The DPMC reduced that number to 155 leases, which is 44 percent of total leases, as of December 1999. Of these 155 leases, 82 were on a month-to-month basis five years or longer.

Inherent in month-to-month lease agreements is a risk of eviction or unanticipated rate increases. Our testing disclosed that during our audit period 13 month-to-month leases were vacated as a result of quit and demand notices from the lessors. During fiscal year 2000 through March 31, 2000, four leases had unusual increases in rent totaling $558,000. The increases ranged from 32 percent to 100 percent of the original monthly lease amount. In addition, 23 of the 155 month-to-month leases had rates per square foot that were higher than published county rates. The excess difference amounted to $1.6 million in fiscal year 1999.
**Recommendation**

We recommend the division review the status of month-to-month leases and ensure that this type of agreement is justified.

**Auditee’s Response**

The DPMC continually reviews month-to-month leases with the goal of reducing as many as possible. Since 1994, the DPMC has aggressively reduced the total number of leases by more than 40 percent. Twenty month-to-month leases have been converted into term leases since the audit period. Presently, the majority of current month-to-month leases are the result of a conscious effort to create “consolidations” which place offices from multiple agencies within a single facility. This permits the tenants to share common areas such as conference, break rooms and storage space. Services such as security, janitorial and trash removal are also shared resulting in significant cost savings. However, since many of the existing leases do not expire concurrent with these consolidation initiatives, month-to-month extensions are often required.