# AUDITOR'S REPORT

# CYPRESS CREEK FINE ART ASSOCIATION AGREEMENT

**August 15, 2014**

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**BARBARA J. SCHOTT, C.P.A.**
**HARRIS COUNTY AUDITOR**

August 15, 2014

Mr. Mike Post
Chief Assistant County Auditor
1001 Preston, 8th Floor
Houston, Texas 77002

Mr. Willie P. Loston
Director, Facilities & Property Management
1310 Prairie, Suite 1330
Houston, Texas 77002

RE: Cypress Creek Fine Art Association Agreement engagement for the 18 months ended February 28, 2014.

The Audit Services Department performed procedures relative to the Cypress Creek Fine Art Association (Association) Agreement. The objective of the engagement was to evaluate controls for collecting and recording quarterly payments from the Association, and to evaluate the compliance with the requirements of the Agreement. Our procedures included the following:

- Reviewed the Association's sworn statement submitted to the County Auditor and the quarterly payments made to the County for the 18 months ended February 28, 2014, to identify whether payments were received and deposited timely, and in accordance with the requirements of the Agreement.

- Identified any late payments and determined whether interest was paid by the Association at the maximum legal rate of interest as required by the Agreement.

- Reviewed the Association's accounting system, and verified the County Auditor's approval of the system as required by the Agreement.

- Reviewed the current insurance policies and the annual reports submitted by the Association, including the supporting documentation as required by the Agreement.

The engagement process included providing you with a combined engagement and scope letter and conducting an entrance and exit conference with your personnel. The purpose of the letter and conferences was to explain the process, identify areas of concern, describe the procedures to be performed, discuss issues identified during the engagement, and solicit suggestions for resolving the issues. A draft report was provided to you and your personnel for review.

The enclosed Auditor's Report presents the significant issues identified during our procedures, recommendations developed in conjunction with your staff, and any actions you have taken to implement the recommendations. Less significant issues and recommendations have been verbally communicated to your staff.

We appreciate the time and attention provided by you and your staff during this engagement.

Sincerely,

Barbara J. Schott
County Auditor

cc: District Judges
County Judge Ed Emmett
Commissioners:
R. Jack Cagle
El Franco Lee
Jack Morman
Steve Radack
Devon Anderson
Vince Ryan
William J. Jackson

# TABLE OF CONTENTS

**OVERVIEW** .......... 5

**RESULTS** .......... 6

**ISSUES AND RECOMMENDATIONS** .......... 7

- **Sworn Statement** .......... 7
- **Quarterly Payments and Interest** .......... 8
- **Association's Expenditures** .......... 10
- **Insurance Coverage** .......... 11

**RISK ASSESSMENT AND SUMMARY OF RECOMMENDATIONS** .......... 14

# OVERVIEW

Local Government Code § 316.022 (LGC) allows Harris County Commissioners Court to enter into a contract with a nonprofit organization, authorizing the nonprofit organization to manage and operate for the general public, a museum, historical site, historical building, or similar building or site in the County. The nonprofit organization may spend funds generated by the admission fees for the payment of costs associated with the administration, maintenance, security, or staffing necessary to operate the building or site as approved by Commissioners Court and provided by the contract. The funds may not be spent for purposes other than those associated with the building or site.

Pursuant to this statute, on October 25, 2005, the County entered into a twenty-year Agreement with the Association to provide a County museum for the general public housed in certain County property located in Spring, Texas. This Agreement has two ten-year extension options. As consideration for the use of the property, the Association will pay 2% of their gross receipts to the County.

# RESULTS

Based on the procedures performed during testing, the controls over the management of the Agreement, and the timely receipt and recording of the Association's quarterly payments need improvement to strengthen the control environment. Controls were developed over time by the County Auditor's Office - Accounts Receivable Department; however, the requirements of the Agreement were not consistently monitored and enforced. The following items were identified:

- The Accounts Receivable Department was not receiving the Association's sworn statement with the quarterly payments as required by the Agreement. In addition, the Accounts Receivable Department did not have a formal process to determine whether the payments received from the Association were correct, nor was there a formal process established to collect outstanding payments when required.

- Five of the eight quarterly payments from September 2012 through February 2014 were received after the due date. Also, the Association was paying less than the required 2% of gross receipts, and the maximum legal rate of interest was not charged to the Association for the late payments as required by the Agreement.

- The Association's accounting records were reviewed to determine whether the expenses reported on the Profit & Loss statements were appropriate; however, the accounting system was not reviewed as it was maintained by a third party CPA firm. Also, although the Agreement assigns the responsibility to the County, the Association has been paying for landscaping and lawn care services surrounding their facility in the amount of $260 per month.

- The Accounts Receivable Department should not be responsible to ensure that the Association's insurance policy was received, maintained, or monitored for the Agreement.

These and other matters are discussed in the attached Issues and Recommendations matrix.

| ISSUES AND RECOMMENDATIONS | | | | |
|---|---|---|---|---|
| **Subject** | **Background** | **Issue** | **Recommendation** | **Management Response** |
| Sworn Statement | Pursuant to the Agreement between the County and the Association, Article V, paragraph B, on or before the last day of each January, April, July, and October, the Association is to furnish the County Auditor a statement sworn to be true and correct by an officer of the Association, certifying the amount of gross receipts for the three-month quarter. This statement will accompany the quarterly payments to the County. | The Accounts Receivable Department was not receiving the Association's sworn statement with the quarterly payments as required by the Agreement.<br><br>Instead, the Association was submitting a letter signed by an officer of the Association with the quarterly payments.<br><br>In addition, the Accounts Receivable Department requested the Association's Profit & Loss (P&L) statements for fiscal year 2012 and 2013 to support the amount paid by the Association; however, the Accounts Receivable Department did not receive individual quarterly P&Ls for Fiscal Year 2012 or the 4th quarter P&L for fiscal year 2013. | Auditor's Office Accounts Receivable Management should establish a formal process to monitor the payments received, and take appropriate action to collect outstanding sworn statements from the Association, when required. | Auditor's Office Accounts Receivable Management will establish a formal process to track the status and follow up, if late, of the Association's quarterly P&Ls and to monitor payments received; will also take appropriate action to collect outstanding sworn statements from the Association, when necessary. |

| ISSUES AND RECOMMENDATIONS | | | | |
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| **Subject** | **Background** | **Issue** | **Recommendation** | **Management Response** |
| Quarterly Payments and Interest | Pursuant to the Agreement between the County and the Association, Article IV, the Association will submit quarterly payments to the County on or before the last day of each January, April, July, and October for the preceding three month period.<br><br>Pursuant to Article III of the Agreement, the Association will pay to the County, without demand, quarterly payments based on two percent (2%) of the gross receipts.<br><br>Pursuant to Article IV, all late payments bear interest at the maximum legal rate of interest. | The Accounts Receivable department's formal policies, procedures and best practices did not address the agreement with the Association to make estimated payments in the absence of financial statements to determine the proper quarterly payments. The estimated payment amount was validated at the beginning of the contract, but without a process in place to follow up on timely delivery of the Association's quarterly financial statements, the correct quarterly payment were not properly calculated. Without financial statements from the Association, outstanding payments and interest, when required, were not properly billed.<br><br>The following issues were identified during the audit: | Auditor's Office Accounts Receivable Management should establish a formal process to monitor the payments received, determine whether the payments are correct, and take appropriate action to collect outstanding balances and interest from the Association. | Going forward, estimated payments will no longer be accepted. Auditor's Office Accounts Receivable Management will establish a formal process to monitor incoming payments and associated financial statements, calculating the appropriate interest charge on late payments. Each payment will be recalculated against the quarterly P&L for accuracy and trued up in the following quarter, if necessary. Late payments will follow Auditor's Office Accounts Receivable formal collections policy (County Auditor Procedure A.28-10). |

| ISSUES AND RECOMMENDATIONS | | | | |
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| **Subject** | **Background** | **Issue** | **Recommendation** | **Management Response** |
| (Continued) Quarterly Payments and Interest | | • Eight quarterly payments were reviewed, which identified that five payments from September 2012 through February 2014 were received after the due date.<br>• The Association was paying less than 2% of gross receipts, and the maximum legal rate of interest was not charged to the Association for the late payments as required by the Agreement.<br>• The Association was submitting estimated payments of approximately $250 per quarter, which were approximately $4,000 less per quarter than the required 2% of gross receipts, resulting in a loss of revenue to the County. | | |

| ISSUES AND RECOMMENDATIONS | | | | |
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| **Subject** | **Background** | **Issue** | **Recommendation** | **Management Response** |
| Association's Expenditures | Pursuant to the Agreement between the County and the Association, Article XI, Paragraph J, the Association has no duty to provide landscaping and lawn care services. | Although the Agreement assigns the responsibility to the County, the Association has been paying for landscaping and lawn care services surrounding their facility in the amount of $260 per month. The fiscal year 2013 P&L recorded approximately $3,076.66 as landscape maintenance, which per the Agreement, is to be paid by the County, not the Association. | Facilities & Property Management (FPM) should review the requirements of the Agreement and determine whether the County should assume responsibility for the lawn and landscaping care, or amend the agreement to assign the responsibility to the Association. In addition, FPM should determine how the monies paid by the Association are addressed. | FPM Response: FPM will review the requirements of the Agreement as to lawn and landscaping care, and determine if the responsibility is that of the Association or the County. Measures will be taken to implement the necessary actions by October 1, 2014. Additionally, FPM will provide a recommendation regarding the money spent (approximately $3,076.66) in 2013 by the Association for landscape maintenance. This recommendation will be made by October 1, 2014.<br><br>Auditor's Office Accounts Receivable Response:<br>County Auditor's Accounts Receivable will invoice total past due revenue and would like to recommend offsetting the total past due amount with the total paid by the Association for lawn and landscaping care, to include |

| ISSUES AND RECOMMENDATIONS | | | | |
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| **Subject** | **Background** | **Issue** | **Recommendation** | **Management Response** |
| (Continued) Association's Expenditures | | | | the recording of revenues and expenses. Will work with FPM to determine how lawn maintenance to be handled going forward. |
| Insurance Coverage | The Accounts Receivable Department is responsible for billing, monitoring, and the pursuit of past due collections for grants and certain receivables of the County including inter-local agreements with other governmental entities. The Department is also responsible for compliance with applicable accounting, contractual, and statutory requirements pertaining to the recording, monitoring, and collecting of amounts owed the County. | The Accounts Receivable Department should not be responsible to ensure that the Association's insurance policy was received, maintained, or monitored for the Agreement. As the agreement is between the Association and FPM, FPM should make sure that the Association maintains appropriate and adequate insurance to protect the County from financial loss through damage or injury. | FPM in conjunction with the County Attorney’s Office should consider pursuing an addendum to the contract for the monitoring and tracking of the required policies of insurance.<br><br>Additionally, FPM should coordinate with Human Resources and Risk Management (HRRM) to verify that the Association’s insurance is adequate insurance to protect the County from financial loss through damage or injury.<br><br>Auditor’s Office Accounts Receivable Management should consider evaluating | FPM Response: On or before October 1, 2014, FPM will contact the County Attorney’s Office and HRRM for guidance on evaluating the Association’s Insurance Policies, and determining the need to amend the contract to allow us to monitor and track the Association’s insurance coverage.<br><br>County Attorney’s Office Response: When requested by FPM, the County Attorney's Office will draft an amendment to the agreement to provide for the monitoring and tracking of the required policies of insurance. |

| ISSUES AND RECOMMENDATIONS | | | | |
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| **Subject** | **Background** | **Issue** | **Recommendation** | **Management Response** |
| (Continued) Insurance Coverage | | | all of the contracts for which they bill to determine whether they contain clauses related to policies of insurance which require monitoring and tracking by the County Auditor’s Office. Upon identifying clauses related to policies of insurance they should consult with the County Attorney’s Office and/or appropriate County departments to determine the proper monitoring mechanism for the insurance policy certificates.<br><br>Going forward, Accounts Receivable Management should review all new contracts in detail for requirements of the Auditor’s Office. If contract requirements related to the Auditor’s Office are not appropriate, the County Attorney’s | Auditor’s Office Accounts Receivable Response: County Auditor’s Accounts Receivable will begin discussions to determine the best way to handle this process. |

| ISSUES AND RECOMMENDATIONS | | | | |
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| **Subject** | **Background** | **Issue** | **Recommendation** | **Management Response** |
| (Continued) Insurance Coverage | | | Office and other applicable County departments should be notified that contract changes, corrections, adjustments, etc. need to be made. | |

# RISK ASSESSMENT AND SUMMARY OF RECOMMENDATIONS

The risk matrix below presents the assessed level of risk or exposure identified during our procedures. Inherent risk relates to factors that because of their nature cannot be controlled or mitigated by management. Inherent risk includes factors such as legislative changes, number and dollar amount of transactions processed, and/or complex nature of transactions. Control risks relate to factors that can be influenced or controlled by management. Controls such as policies and procedures, electronic or manual approvals, system security access, and separation of job responsibilities may be instituted by management in order to mitigate control risk. Control risk is assessed during the planning phase in order to establish the nature, timing, and extent of testing and at the conclusion of the engagement in order to incorporate actions taken to implement our recommendations. The overall risk considers a combination of inherent and control risks.

<table>
<tr><td>Inherent Risk:</td><td colspan="2">Control Risk:</td><td>Overall Risk:</td></tr>
<tr><td rowspan="2">☐ High<br>☒ Moderate<br>☐ Low</td><td>Prior to Procedures</td><td>After Procedures</td><td rowspan="2">☐ High<br>☒ Moderate<br>☐ Low</td></tr>
<tr><td>Inadequate</td><td>Adequate</td></tr>
<tr><td colspan="4">Type of Procedures: Audit</td></tr>
<tr><td colspan="4">Purpose: To evaluate controls for collecting and recording quarterly payments from the Association, and to evaluate the compliance with the requirements of the Agreement</td></tr>
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<tr><td>Priority Rating:</td><td>Audit Recommendations: County Auditor - Accounts Receivable Department and Facilities & Property Management (FPM)</td></tr>
<tr><td>1</td><td>Auditor’s Office Accounts Receivable Management should establish a formal process to monitor the payments received, and take appropriate action to collect outstanding sworn statements from the Association, when required.</td></tr>
<tr><td>1</td><td>Auditor’s Office Accounts Receivable Management should establish a formal process to monitor the payments received, determine whether the payments are correct, and take appropriate action to collect outstanding balances and interest from the Association.</td></tr>
<tr><td>1</td><td>FPM should review the requirements of the Agreement and determine whether the County should assume responsibility for the lawn and landscaping care, or amend the agreement to assign the responsibility to the Association. In addition, FPM should determine how the monies paid by the Association are addressed.</td></tr>
<tr><td>1</td><td>FPM in conjunction with the County Attorney’s Office should consider pursuing an addendum to the contract for the monitoring and tracking of the required policies of insurance. Auditor’s Office Accounts Receivable Management</td></tr>
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| | should consider evaluating all of the contracts for which they bill to determine whether they contain clauses related to policies of insurance which require monitoring and tracking by the County Auditor's Office. Upon identifying clauses related to policies of insurance they should consult with the County Attorney's Office and/or appropriate County departments to determine the proper monitoring mechanism for the insurance policy certificates. |

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| **Priority Rating** | **1. Implement immediately (30 – 90 days) –** Serious internal control deficiencies or recommendations to reduce costs, maximize revenues, or improve internal controls that can be easily implemented.<br>**2. Work towards implementing (six – 18 months) –** Less serious internal control deficiencies, or recommendations that can not be implemented immediately because of constraints imposed on the department (i.e., budgetary, technological constraints, etc.).<br>**3. Implement in the future (two – three years) –** Recommendations that should be implemented, but that can not be implemented until significant and/or uncontrolled events occur (i.e., legislative changes, buy and install major systems, requires third party cooperation, etc.). |