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Inspector General

OFFICE OF INSPECTOR GENERAL
PALM BEACH COUNTY



Inspector General
Accredited

“Enhancing Public Trust in Government”

Audit Report

2018-A-0004

**Town of Cloud Lake
Revenue**

February 26, 2018



OFFICE OF INSPECTOR GENERAL
PALM BEACH COUNTY



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DATE ISSUED: FEBRUARY 26, 2018

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TOWN OF CLOUD LAKE – REVENUE

SUMMARY

WHAT WE DID

We conducted a revenue audit of the Town of Cloud Lake (Town). This audit was performed as part of the Office of Inspector General, Palm Beach County (OIG) 2018 Annual Audit Plan.

Our audit focused on revenue and related cash receipt activities that occurred during Fiscal Year (FY) 2016 and FY 2017 (October 1, 2015 – September 30, 2017). Based on observations made during the fieldwork, we expanded the original scope of the audit to include review of the Town's investments for FY 2016 and FY 2017.

WHAT WE FOUND

We found generally adequate controls for the receipt of revenue and proper recording of financial transactions. We found weaknesses in the validation of revenue received from a Sign Location Lease Agreement and investment practices. Our audit identified **\$18,479** in

questioned costs¹ and **\$18,690** in avoidable costs.²

Investments

The Town properly protected taxpayer funds and maintained funds in qualified public depository accounts in accordance with Florida Statutes.

The Town lost potential interest revenue by not investing excess funds in higher yield accounts that would have optimized investment returns while prioritizing safety of principal and liquidity. This resulted in lost potential revenue of approximately \$12,459 for FY 2016 and FY 2017. Our recommendation to optimize Town investments should result in approximately **\$18,690** in future avoidable costs.

Revenue

The Town receives a large portion of its revenue from a Sign Location Lease agreement (Agreement) with CBS Outdoor LLC n/k/a Outfront Media LLC (Outfront Media). The Agreement grants Outfront Media the right to construct and

¹ Questioned costs are costs or financial obligations that are questioned by the OIG because of: an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, other agreement, policies and procedures, or document governing the expenditure of funds; a finding that, at the time of the OIG activity, such cost or financial obligation is not supported by adequate documentation; or, a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable.

² Avoidable costs are costs an entity will not have to incur, lost funds, and/or an anticipated increase in revenue following the issuance of an OIG report. The maximum period for calculating Avoidable Costs shall typically be three years from the issuance of the OIG report, except in instances where it involves a contract with a specified contract period.

operate an advertising sign (i.e. billboard) on the Town's property. In return, the Town is entitled to receive a percentage of the lessee's monthly net revenue from the billboard, which includes a minimum monthly guaranteed rent payment.

The Agreement requires the rent payment be supported with an accounting of the amount and a copy of the applicable advertising sales contract. The Town did not obtain the required supporting documentation for the period audited; therefore, we questioned costs of approximately **\$5,738**. Without the supporting documentation, the Town is at risk of not receiving the full amount of revenue due under the Agreement.

Potential Sales Tax Owed

According to section 212.031, Florida Statutes, a lessor may be responsible for collecting and remitting sales tax on lease revenue to the Florida Department of Revenue. In an amendment to the Agreement, Outfront Media agreed to remit all applicable sales tax arising out of the Agreement directly to the applicable taxing authority. Even though the responsibility for remittance was delegated to Outfront Media, the Town did

not obtain documentation from Outfront Media to verify that the sales tax payments were properly remitted.

Therefore, the Town is potentially responsible for paying any outstanding sales tax owed to the Florida Department of Revenue, plus penalties and interest. The total questioned costs are approximately **\$12,741**³ due to the lack of supporting documentation.

WHAT WE RECOMMEND

Our report contains three findings and seven recommendations. Implementation of these recommendations will 1) assist the Town in strengthening internal controls, 2) save approximately **\$18,690** in future avoidable costs, and 3) enhance compliance with the lease agreement.

The Town concurred and accepted seven recommendations and is taking corrective actions to implement the recommendations.

We have included the Town's management response as Attachment 1.

³ Sales tax \$8,006 + Penalties \$4,003 + Interest \$732 = \$12,741 Potential obligation of the Town for the revenue received in FY 2016 and FY 2017.

BACKGROUND

The Town of Cloud Lake (Town) was incorporated in 1951. The name of the Town originates from a five-acre lake created during a land excavation for the Seaboard Air Line Railroad. Kenyon and Karl Riddle, twin brothers and engineers who began building homes nearby in 1935, named the lake after Seminole Indian Chief Yaholoochee, meaning "The Cloud." The Town is bordered on the east by I-95 and the City of West Palm Beach, and on the north by Palm Beach International Airport. The current population is approximately 134 residents.

The Town has a Mayor-Council form of government. The Town Council includes the Mayor and four Council members.

The OIG 2018 Annual Audit Plan had multiple entities selected for revenue audits. The Town was selected for audit since it has not been previously audited by the OIG.

A Sign Location Lease agreement made up approximately 50% of the Town's revenue in FY 2016 and 2017.

Lease Agreement Background

On March 13, 2006, the Town executed the Agreement with CBS Outdoor LLC n/k/a Outfront Media LLC (Outfront Media) to lease a small piece of the Town's property for an initial term of ten (10) years. The lease provides Outfront Media the rights to build and operate a billboard for advertising purposes. Outfront Media owns the billboard and all structural improvements and is responsible for paying the Town a monthly rent equal to the greater of 55% of the lessee's monthly net revenue (gross revenue less an agency fee of up to 15%) or the minimum guaranteed rent amount. To support the payment amount, the Agreement requires Outfront Media to provide the Town with an accounting and a copy of any applicable advertising sales contracts "each and every month." Additionally, Exhibit B of the lease required Outfront Media to pay sales tax.

Effective July 23, 2014, the Agreement was amended to: 1) extend the term for another ten (10) years through September 20, 2024; 2) reduce the Town's percentage share of net revenue from 55% to 45%, with agency fees up to 16.67%, beginning on October 1, 2014; and 3) require the lessee to pay all sales tax arising from the lease directly to the applicable taxing authority.

OBJECTIVES, SCOPE, AND METHODOLOGY

The overall objectives of the audit were to determine if:

- Revenue controls were adequate for the receipt of revenue and/or cash intake/receipt activities;
- Revenues were recorded appropriately and accurately in compliance with financial requirements; and
- Cash receipts were accurately and timely recorded.

The initial scope of the audit included, but was not limited to, revenue and related cash receipt activities that occurred during the period of October 1, 2015 through September 30, 2017. Based on observations made during the audit engagement, we expanded the scope to include review of the Town's investment activities for the aforementioned audit period.

The audit methodology included, but was not limited to:

- Review of revenue/cash receipt policies and procedures;
- Review of banking and accounting records for timely deposits;
- Review of potential investment guidance;
- Interview of appropriate personnel; and
- Detailed testing and reconciliation of selected revenue and cash receipt transactions.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FINDINGS AND RECOMMENDATIONS

Finding (1): The Town lost potential interest revenue that may lessen the taxpayer's burden.

The Town does not have an investment policy; therefore, it is required to follow section 218.415(17), Florida Statutes, which states units of local government may invest surplus public funds in their control or possession in any of four different types of investment tools which provide sufficient liquidity to pay obligations as they come due.

During FY 2016 and FY 2017, the Town maintained an average total balance of \$744,254⁴ between its four low yield interest-bearing bank accounts. The interest rate yields on these accounts varied from 0.02% to 0.36% and resulted in \$1,933 of interest revenue for the Town during that period.

We completed an analysis of available investment options that meet the Town's accepted risk levels and use standard bank accounts to ensure immediate access to funds. We concluded that if the Town used a different qualified public depository to provide a money market bank account which consolidated all of the Town's bank accounts, the Town could have increased its interest rate yield to 0.995%.

We took the actual bank account balances less the funds needed for operating expenses and determined that the new average amount of excess funds available for investment was approximately \$723,221.⁵ Based on our calculations and the interest rate yield of 0.995%, we determined that had the Town invested in a higher-yield bank account, the Town could have earned interest of approximately \$14,392. The Town lost potential interest revenue of approximately \$12,459⁶ by not investing excess funds in a higher yield interest-bearing account.

If the Town takes the OIG recommendation to invest excess funds in a higher yield interest-bearing account, over the next three years the Town could earn additional interest

⁴ This amount is the average of all four bank account balances which includes the Town's operating checking account. All accounts used are with qualified public depositories and in compliance with Florida Statute requirements.

⁵ Actual bank balances were used for the calculation which varied on a monthly basis. The operating checking account was reduced for the calculations to leave approximately \$21,000 available for operations which was kept separate of this calculation. The highest month expenditure in FY 2016 and FY 2017 was approximately \$15,136.

⁶ Estimated potential interest for FY 2016 and FY 2017 of \$14,392 less the actual interest of \$1,933 equals \$12,459 of lost potential interest revenue.

revenue of approximately \$18,690.⁷ This is considered an avoidable cost because it is an anticipated increase in interest revenue for the Town.

Recommendations:

- (1) The Town consider investing excess funds in a higher yield (Qualified Public Depository) bank account based on approved risk levels to maximize the interest revenue earned or one of the other options available under section 218.415(17), Florida Statutes.**
- (2) The Town consider adopting an investment policy to document the types of accounts approved for investments.**

Management Responses:

- (1) Town will invest excess funds in a higher yield Qualified Public Depository bank based on approved risk levels to maximize the interest revenue earned.**
- (2) In addition to currently following the Florida Statutes on investments of Public Funds, the Town will be establishing a Town Investment Policy.**

Finding (2): Lack of supporting documentation to validate lease revenue received.



The Town entered into an Agreement that grants Outfront Media the right to construct and operate a billboard located on the Town's property for advertising purposes. The Agreement requires that Outfront Media pay the Town rent in an amount equal to the greater of the monthly minimum guaranteed rent or the percentage share of monthly net revenue.

In addition, Outfront Media is required to provide the Town with an accounting of the monthly rent amount paid and copies of the advertising sales contracts each month to support the monthly payment. The Agreement and related payments are discussed in more detail in the Background section of this report titled "Lease Agreement Background".

In FY 2016 and FY 2017, the Town received the minimum guaranteed rent amounts for 16 of 24 monthly payments. For the eight (8) remaining monthly payments, the Town received the percentage share of monthly net revenue, which exceeded the minimum guaranteed rent amount by approximately \$5,738.⁸ The Town did not receive copies of any sales contracts, as required by the lease, to support any of the 24 monthly payments reviewed.

⁷ Lost potential interest revenue $\$12,459 / 2 \text{ years} = \$6,230$ Potential interest revenue per year. $\$6,230 \times 3 \text{ years} =$ approximately \$18,690 additional interest revenue.

⁸ The Town received payments in excess of the minimum guaranteed payment amount totaling \$810.05 for FY 2016 and \$4,928.24 for FY 2017.

Without the sales contracts, the Town does not have sufficient documentation to determine whether the revenue received from Outfront Media was accurate. The Town's inability to confirm the accuracy of rent payments received puts it at risk of not receiving the full amount of revenue required by the lease; therefore, the amount of **\$5,738** is considered a questioned cost.

Recommendations:

- (3) The Town obtain the required documentation for future rent payments from Outfront Media and verify those amounts paid are in accordance with the lease agreement.**
- (4) The Town obtain the required documentation for past rent payments from Outfront Media and complete a reconciliation to determine if revenue payments received were correct. If the correct amounts were not received, the Town should require Outfront Media to pay the additional amounts owed.**

Management Responses:

- (3) Outfront Media notified to supply Town required documentation and verify amounts paid are in accordance with lease agreement.**
- (4) Outfront Media notified to supply required documentation for past rental payments so Town can reconcile and determine if payments received were correct and if not correct Outfront Media to pay additional amounts owed.**

Finding (3): Lack of supporting documentation to show lessee's payment of taxes.



Section 212.031(1)(c), Florida Statutes establishes that during the audit period, the leasing of real property was taxable at the rate of 6.0%⁹ for the total rental fee of the real property and that Outfront Media is responsible for paying this tax. Florida Administrative Code Rule 12A-1.070 further clarifies that this tax shall be due and payable at the time the rental or fee payment is received by the Town, and that the Town shall remit the tax to the Florida Department of Revenue.

According to the Town's Agreement with Outfront Media, the "required sales tax shall be paid by the Lessee." On February 23, 2014, an Amendment was executed and became effective on July 23, 2014, that stated that Outdoor Media shall pay all applicable sales tax arising out of the rent paid directly to the applicable taxing authority. While it is acceptable to pass the responsibility of the sales tax payments to Outdoor Media, the Town may be held responsible for any unpaid sales tax arising from the Agreement.

⁹ Beginning on January 1, 2018, the tax rate will be reduced to 5.8%.

We reviewed the Town's records and confirmed there were no payments remitted by the Town to the Florida Department of Revenue for sales tax owed on the Agreement in FY 2016 or FY 2017. Additionally, no documents were provided to show that the Town ensured the sales tax payments were properly remitted by the lessee. Consequently, the Town may be at risk of owing the sales tax, including any applicable interest¹⁰ and penalties,¹¹ related to the Agreement payments received.

Since the Town did not obtain documentation from Outdoor Media, neither the actual amount of sales tax due to the taxing authority nor the amount paid can be determined from the Town's records. We calculated the tax obligation for FY 2016 and FY 2017 including potential interest and penalties based on the lease payments received by the Town, which totaled \$125,738. Potential amounts owed for sales tax, penalties, and interest total \$8,006,¹² \$4,003,¹³ and \$732,¹⁴ respectively. The total of potential sales tax, penalties, and interest that the Town could owe the Florida Department of Revenue is approximately **\$12,741**.¹⁵ This is considered a questioned cost due to lack of supporting documentation to prove payments were made appropriately.

Recommendations:

- (5) The Town consider executing a lease amendment to clarify the terms relating to sales tax and clearly define the documentation required to be provided to the Town to verify sales tax was paid by Outfront Media.**

- (6) The Town consider assuming the responsibility for collection and remittance of applicable sales tax directly to the Florida Department of Revenue as landlord/lessor to ensure the proper amount of sales tax due is timely and properly remitted.**

¹⁰ Interest shall accrue on any delinquent tax, surtax, surcharge, or fee imposed by Florida Statute Chapter 212, at the rate of interest established pursuant to Florida Statute Chapter 213.235 and is prorated daily. Interest accrues on the amount due from the date of delinquency until the date the tax is paid.

¹¹ Florida Statute Chapter 212 states the party required to make a return or to pay any tax, surtax, surcharge, or fee imposed who fails to disclose such on a return is subject to a penalty of 10% of the amount of tax, surtax, surcharge, or fee owed on the return for each 30-day late period. The penalty may not exceed 50% of the total unpaid tax or fees.

¹² The potential sales tax owed was calculated by multiplying each lease payment during the audit period by the applicable sales tax rate for the period. The sales tax rate from October 1, 2015 through December 31, 2016 was 6%. The sales tax rate from January 1, 2017 through September 30, 2017 was 7%. The increase to 7% was due to the 1% discretionary sales surtax for Palm Beach County effective January 1, 2017.

¹³ Sales tax \$8,006 x Penalty rate 50% = \$4,003 Potential penalties owed. As of the date of this report, all owed tax is more than five months (10% per month) past due, thus a 50% penalty rate was used in our calculation of the total amount of potential penalties.

¹⁴ The Florida Department of Revenue provides interest rates and daily interest rate factors for taxpayers to determine the interest due on deficiencies (underpayments) in its Tax Information Publications. Publication No. 17ADM-02 issued on November 15, 2017 provides the calculation method and applicable daily interest rate factors effective as of the date of this report and used for our calculation of the potential interest amount due of \$732.

¹⁵ Sales tax \$8,006 + Penalties \$4,003 + Interest \$732 = \$12,741 Potential obligation of the Town.

- (7) The Town obtain documentation of proof of payment for prior sales tax obligations to ensure the proper amounts were remitted. If the correct amounts were not paid, the Town should require Outfront Media to pay the additional amounts owed including applicable penalties and interest.

Management Responses:

- (5) Lease to be amended to clarify terms relating to sales tax and clearly define documentation required to be provided to Town.
- (6) Town will consider assuming responsibility once again for collection and remittance of sales tax directly to Florida Department of Revenue to ensure proper amount of sales tax due is timely and properly remitted.
- (7) Outfront Media notified to provide to Town documentation of proof of payment for prior sales tax obligations to ensure proper amounts were remitted. If correct amounts were not paid Outfront Media required to pay any additional amount owed including applicable penalties and interest and provide proof to Town verifying payment to Florida Department of Revenue.

**SUMMARY OF POTENTIAL FINANCIAL AND OTHER BENEFITS
IDENTIFIED IN THE AUDIT**

Questioned Costs

Finding	Description	Questioned Costs
2	Revenue	\$5,738
3	Potential Sales Tax Owed	<u>12,741</u>
	TOTAL QUESTIONED COSTS	\$18,479

Avoidable Costs

Finding	Description	Avoidable Costs
1	Investments	<u>\$18,690</u>
	TOTAL AVOIDABLE COSTS	\$18,690

ATTACHMENT

Attachment 1 – Town of Cloud Lake’s Management Response, page 11-12

ACKNOWLEDGEMENT

The Inspector General’s audit staff would like to extend our appreciation to the Town of Cloud Lake staff for their assistance and support in the completion of this audit.

This report is available on the OIG website at: <http://www.pbcgov.com/OIG>. Please address inquiries regarding this report to Director of Audit, by email at inspector@pbcgov.org or by telephone at (561) 233-2350.

ATTACHMENT 1 – TOWN OF CLOUD LAKE'S MANAGEMENT RESPONSE



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February 20, 2018

To: Megan Gaillard, Director of Audit
Office of the Inspector General

From: Dorothy C. Gravelin, Town Clerk

CC: John Carey, Inspector General

Subject: Response to the Findings of Audit Report 2018-A-0004
Office of Inspector General of Palm Beach County

The Audit focused on revenue and related cash receipts activities that occurred during Fiscal Years 2016 and 2017 from October 1, 2015 – September 30, 2017. The report contained three findings and seven recommendations.

The Town concurred, accepted the seven recommendations, and is taking corrective action to resolve these recommendations.

FINDING 1: The Town lost potential interest revenue that may lessen the taxpayer's burden.

Recommendation 1 – The Town consider investing excess funds in a higher yield (Qualified Public Depository) bank account based on approved risk levels to maximize the interest revenue earned or one of the other options available under section 218.415(17), Florida Statutes

Response: Town will invest excess funds in a higher yield Qualified Public Depository bank based on approved risk levels to maximize the interest revenue earned.

Recommendation 2 – The Town consider adopting an investment policy to document the types of accounts approved for investments.

Response: In addition to currently following the Florida Statutes on Investments of Public Funds, the Town will be establishing a Town Investment Policy.

FINDING 2: Lack of supporting documentation to validate lease revenue received.

Recommendation 3 – The Town obtain required documentation for future rent payments from Outfront Media and verify those amounts paid are in accordance with the lease agreement.

Response: Outfront Media notified to supply Town required documentation and verify amounts paid are in accordance with lease agreement.

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Recommendation 4 – The Town obtain the required documentation for past rent payments from Outfront Media and complete a reconciliation to determine if revenue payments received were correct. If the correct amounts were not received the Town should require Outfront Media to pay the additional amounts owed.

Response: Outfront Media notified to supply required documentation for past rental payments so Town can reconcile and determine if payments received were correct and if not correct Outfront Media to pay additional amounts owed.

FINDING 3: Lack of supporting documentation to show lessee’s payment of taxes.

Response: The original lease dated March 13, 2006 required sales tax to be paid by Town and it was paid to Florida Department of Revenue. Lease amendment dated July 23, 2014 provided Outfront Media pay sales tax directly to Florida Department of Revenue. January 8, 2015 received confirmation from Outfront Media paying sales tax directly to Florida Department of Revenue.

Recommendation 5 – The Town consider executing a lease amendment to clarify the terms relating to sales tax and clearly define the documentation required to be provided to the Town to verify sales tax was paid by Outfront Media.

Response: Lease to be amended to clarify terms relating to sales tax and clearly define documentation required to be provided to Town.

Recommendation 6 - The Town consider assuming the responsibility for collection and remittance of applicable sales tax directly to the Florida Department of Revenue as landlord/lessor to ensure proper amount of sales tax due is timely and properly remitted.

Response: Town will consider assuming responsibility once again for collection and remittance of sales tax directly to Florida Department of Revenue to ensure proper amount of sales tax due is timely and properly remitted.

Recommendation 7 – The Town obtain documentation of proof of payment for prior sales tax obligations to ensure proper amounts were remitted. If the correct amounts were not paid, the Town should require Outfront Media to pay the additional amounts owed including applicable penalties and interest.

Response: Outfront Media notified to provide to Town documentation of proof of payment for prior sales tax obligations to ensure proper amounts were remitted. If correct amounts were not paid Outfront Media required to pay any additional amount owed including applicable penalties and interest and provide proof to Town verifying payment made to Florida Department of Revenue.