

City of



Budget and Management Studies – Internal Audit

DATE: March 7, 2011

TO: PATRICK WIEMILLER, Director
Public Utilities and Public Works Departments

THROUGH: RENENA SMITH, Budget Director *RS*
Budget and Management Studies

FROM: BOB KOURY, Principal Internal Auditor *Bob Koury*
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Budget and Management Studies - Internal Audit

SUBJECT: FOLLOW-UP AUDIT – DEPARTMENT OF PUBLIC UTILITIES' (DPU) REVENUE
CONTRACTS AND PROPERTY LEASES AUDIT

Attached is the Follow-up Audit Report related to the DPU's Revenue Contracts and Property Leases Audit issued on June 28, 2010 (The complete original audit report can be found on the City's Internal Audit web site for reference purposes if necessary.) This follow-up audit was performed in accordance with AO 1-12 and Government Auditing Standards.

The former DPU Director provided a response and current status to the 38 original audit recommendations. Internal Audit performed follow-up procedures and determined the status as follows:

- 16 Fully Implemented
- 13 Partially Implemented
- 6 No Longer Applicable
- 1 Unable to Implement and 2 Not Implemented

We wish to thank you and the DPU Management staff for your assistance during the course of this follow-up audit. If you have any questions or we can be of any further assistance to your Department, please contact Bob Koury, Principal Internal Auditor at 621-7072 or Mary Viancourt, Internal Auditor at 621-7794.

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Budget and Management Studies – Internal Audit

**INTERNAL AUDIT'S
FINAL FOLLOW-UP AUDIT REPORT**

**Department of Public Utilities
Revenue Contracts and Property Leases Audit**

Audit Number 11-0009

**Performed by:
Mary Viancourt, Internal Auditor
Budget and Management Studies – Internal Audit**

Issued on March 7, 2011

TABLE OF CONTENTS

EXECUTIVE SUMMARY1

INTRODUCTION

Background3

Audit Objectives3

Audit Scope and Methodology3

Audit Conclusion4

REPORT SECTIONS - RESULTS AND RECOMMENDATIONS

Department of Public Utilities

I. Department/Division’s Contract Administrator’s Duties5

Community Sanitation Division’s Revenue Contract

II. State of California’s Department of Transportation’s Agreement For Maintenance of State Highways in the City of Fresno6

Solid Waste Division’s Revenue Contract

III. Sunset’s Agreement for Processing Services for Recyclable Materials9

Wastewater Division’s Property Leases

IV. Lease Agreement between the City of Fresno and Stephen and Analisa England 21

V. Lease Agreement between the City of Fresno and Quist Dairy32

Water Division’s Property Leases

VI. City of Fresno’s Communications Site License Agreement with Cricket California Property Company39

VII. Other Water Division Cell Tower Leases42

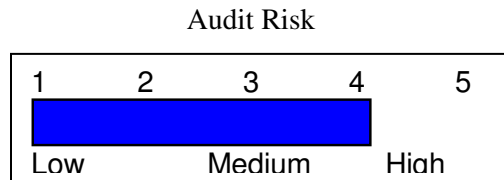
VIII. Lease and Adaptive Reuse Agreement Between City of Fresno - Fresno Convention and Visitors Bureau Regarding The Historic Fresno Water Tower42

Executive Summary

Based on the results of this audit from a sample of the Department of Public Utilities' (DPU) Revenue Contracts and Property Lease Agreements, the more significant audit findings are summarized below. This audit report is intended to assist both DPU Management and other City Departments in the performance of their responsibilities, administration, oversight and contract compliance related to their respective revenue contract and property leases.

While performing the audit, Internal Audit considered whether improvements could be made to strengthen the existing Contract Process. This report provides some areas for DPU Management to consider for fiscal management and customer service.

Risk is the degree of or the lack of internal controls, management oversight and fiscal responsibility. Based upon Internal Audit's findings, the DPU's Revenue Contracts and Property Leases Process risk is medium to high.



Key Issues Identified:

1. Each DPU Division does not have one assigned person and one back-up person who are responsible for monitoring full compliance of their Revenue Contracts and Property Leases. Multiple employees (including employees from other Departments) are responsible for performing or monitoring various parts of the Contracts or Leases. The lack of an assigned Divisional Employee to monitor full compliance with all terms of the Contracts or Leases puts the City at risk.
2. Employees who may be responsible for performing a portion of the Contract or Lease do not have a copy of the Contract/Lease document. Further, the employee performing a Contract/Lease function may not interact with the Contracted Party or Lessee. The lack of having a complete copy of the current Contract or Lease and Exhibits places the employee performing a specific process at a disadvantage and at risk of improperly performing their assigned duties.
3. Decisions are being made to forego enforcing some term(s) of the Contract or Lease (e.g. Not charging a Late Penalty; Not ensuring all required Insurance Coverage; Not requiring or receiving all required reports, etc.) without amending the Contract/Lease or creating a formal letter that is signed by both parties. The Contract/Lease is a legal document and not enforcing all terms of the written document places the City at risk especially if there are like Contracts/Leases with other Parties.

4. Current processes from drafting through termination of the Contract/Lease are inefficient. Inefficient processes can and do result in errors in the document language, payment terms, not recording the receipt date for assessment of late penalties, and/or lack of proper record keeping.
5. Internal Audit noted potential City Revenue not assessed and received; however, Internal Audit was unable to conclude with certainty that all payments or penalties for four out of six DPU Contracts/Leases audited (State of California Department of Transportation, Sunset Waste Paper Inc., Stephen and Analisa England, and Quist Dairy) were properly assessed, paid or late penalties assessed and paid per terms of the Contract/Lease.
6. Internal Audit did not receive a formal, written Management Response for 28 out of the 38 Audit Findings from each DPU Division or the Director indicating what specific action would be taken to correct the Audit Finding and when the corrective action would be implemented. Therefore, with concurrence between the DPU Director and the Principal Internal Auditor, one Management Response has been inserted for three Divisions' Audit Findings.

Subsequent to the issuance of the initial audit report on June 28, 2010, and at the direction of the City Manager's Office, the former DPU Director submitted "Revised Management Responses" to Internal Audit on November 24, 2010.

INTRODUCTION

Background

As a “Best Practice”, the Internal Audit function of an organization periodically conducts a Risk Assessment of the entire organization to determine where the greatest exposure of potential risk/liability is in the organization. Given the changes in the economy and other factors potentially influencing City Services to the Citizens of Fresno since the last Risk Assessment, the Internal Audit Section conducted a Citywide Risk Assessment during 2009 which was used to develop an Annual Audit Plan for Fiscal Years (FY) 2010 and 2011. As part of that Risk Assessment, Internal Audit looked for an area(s) of exposure to the City from potential lost revenue.

One area Internal Audit identified during the Risk Assessment and from a few prior Audits is lost Contract and Lease Revenue. Internal Audit obtained a current listing of all agreements, contracts, grants, and leases from each City Department in August 2009. From the listings received, Internal Audit noted the Department of Public Utilities (DPU) is one of the three highest Departments with Revenue Contracts and Property Leases. Four out of five DPU’s Divisions (Community Sanitation, Solid Waste, Wastewater, and Water) have approximately 40 Revenue Contracts and Property Leases totaling approximately \$460,000 annually. Internal Audit selected six out of the approximately 40 Contracts/Leases to audit.

Audit Objectives

Internal Audit’s primary audit objectives were to:

1. Determine if DPU has a current listing of all Revenue Contracts and Property Leases.
2. Determine if DPU has a Contract Administrator and whom the Administrator reports to.
3. Determine if any DPU Contracts/Leases have expired but are still being enforced/utilized.
4. Determine if the Departmental/Divisional Contract Administrator is monitoring and enforcing all the terms of the Contracts/Leases.
5. Determine if DPU is collecting, depositing, and reporting all revenue collected from these Contracts/Leases in a timely manner or assessing Late Penalties.

Audit Scope and Methodology

Internal Audit performed the DPU Revenue Contracts and Property Leases Audit during the period January through May 2010, in accordance with Administrative Order 1-12 and Generally Accepted Government Auditing Standards. Internal Audit used the following documents/procedures:

- Internal Audit conducted a review of all City Administrative Orders to determine who is responsible for Contract Administration and who is required to receive information related to Contracts and Leases entered into by the City of Fresno.
- Internal Audit conducted interviews with the DPU Director and designated Assistants/Staff Members.

- Internal Audit requested a current list of DPU's Contracts and Leases as of February 2010.
- In conjunction with the DPU Director, Internal Audit selected a sample of Contracts and Leases to review and test for compliance.
- Internal Audit obtained a hardcopy of each selected Contract and Lease(s) from the appropriate Division.
- Internal Audit verified monthly/yearly Contract/Lease revenue in the PeopleSoft System.
- Internal Audit tested the DPU's Divisional monitoring and enforcing of Contract/Lease terms.
- Internal Audit conducted site visits of the Contracted Party or Lessee's property.

Audit Conclusion

The DPU Management and staff is a professional group of individuals. Their duties are varied based upon the Division they work in, the regulatory requirements for their environment, and the needs of their customers and/or Citizens of Fresno.

However, Internal Audit noted some areas during the course of this audit that DPU Management should address to strengthen Internal Controls and Work Processes for greater operational effectiveness and efficiencies and a more consistent enforcement of Contract/Lease terms. These areas are addressed throughout this Audit Report.

REPORT SECTIONS - RESULTS AND RECOMMENDATIONS

DEPARTMENT OF PUBLIC UTILITIES

I. Department/Division's Contract Administrator's Duties

Internal Audit identified a number of Administrative Orders (AO), which require each Department to have a Contract Administrator to administer, track, and monitor Contracts/Leases for their respective Department/Division. The AOs are as follows:

- AO 1-1 Grants Administration (Finance) - Issued on December 1, 1998
- AO 4-1 Processing of Contracts to Which the City is Party (City Attorney) - Revised on November 9, 2006
- AO 6-22 Contract Compliance System (City Manager) - Issued on November 9, 2006

The duties and responsibilities of the Contract Administrator are not clearly defined in the above noted AOs. As a result of Internal Audit's Citywide Contract Compliance Audit Report issued February 16, 2010, a new AO was drafted to replace AOs 4-1 and 6-22 and to more clearly define the Contract Administrator's responsibilities. The newly drafted AO is currently under review for approval and distribution by the City Manager's Office as of our audit date.

Throughout the DPU Contracts/Leases Audit, Internal Audit noted the following:

- Employees designated as the Responsible Party may have no actual monitoring and/or compliance responsibility for the Contract/Lease and therefore are not ensuring full compliance with all Contract/Lease Terms (including issuing a Default Notice).
- Multiple employees within a Division and/or another Department are responsible for various contractual obligations of these Contracts/Leases.
- The employee responsible for the financial aspect of the Contract/Lease does not or may not have a copy of the Contract/Lease and may not interact with the Contracted Party or the Lessee.
- The Division's Responsible Party (Contract Administrator), does not have current, accurate, and complete records for audit and/or verification of all required Contract/Lease terms (.e.g. the Contract document, Amendments, and Exhibits; Financial Records; and or Documents for required deliverables from the Contracted Party/Lessee).

Audit Recommendation:

1. The Director of DPU in conjunction with the Assistant Directors/Division Managers should develop a process for a Contract Administrator within each Division at a minimum who is ultimately responsible for the complete oversight of the monitoring, tracking, and compliance

of all current Contract/Lease terms for their Division even if a portion(s) of the Contract Terms are delegated to different employees within the Division and/or another City Department.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 1 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 1 Dated November 24, 2010

The Department will remind the Division Managers of their responsibility for oversight of monitoring, tracking and compliance of all current Contact/Lease terms for their Divisions at the next weekly Department Executive Staff meeting held on November 24, 2010 and I will remind Managers of same during quarterly financial meetings with the Department.

INTERNAL AUDIT'S FOLLOW-UP COMMENT – NOT IMPLEMENTED

The former DPU Director did not provide proof that a process has been developed for each Division Contract Administrator.

COMMUNITY SANITATION DIVISION'S REVENUE CONTRACT

II. State of California's Department of Transportation's Agreement For Maintenance of State Highways in the City of Fresno

The Community Sanitation Division (Community Sanitation) provided Internal Audit with their most recently executed contract with the State of California dated December 31, 1990. In addition, Community Sanitation also provided Audit with Sanitation's original Revenue Contract with the State of California dated July 1, 1964. Internal Audit reviewed both of these Contracts which included terms for the City of Fresno to provide Street Maintenance functions (Median Island Cleaning; Street Sweeping; and Maintenance of Street Lights and Traffic Signals) on portions of State Routes (SR) 41, 99, 168, and 180 within the City of Fresno.

The Department of Public Utilities (DPU) currently lists the State of California's Department of Transportation Contract as one of their current Revenue Contracts, although both the DPU and Department of Public Works (DPW) are contractually obligated to perform certain services under the current contract. Some provisions of the current contract have been delegated to a third Department (Finance). Therefore, the designated Division Responsible Party does not fully administer and monitor this contract.

Internal Audit inquired and received from the DPW updated Freeway Maintenance Agreements for SR 99 as of May 27, 1992 and SRs 41 and 168 as of July 19, 2005. The DPW informed Internal Audit there were other Contracts for services on the SRs in the City Clerk's Files.

Internal Audit reviewed the City Clerk's Citywide Agreement Listing dated August 28, 2009 which showed an Agreement with the State of California Department of Transportation dated March 2, 2009 for a Cooperative Agreement affecting SRs within the jurisdiction of LOCAL AGENCY (City of Fresno). Internal Audit also reviewed the City Clerk's Contract Files and found other 2009 Contracts between the City and State for service on SRs.

Internal Audit noted the following audit issues:

A. Lack of a Complete Formal Contract and Exhibits

The State of California's Department of Transportation Contract with the City of Fresno dated December 31, 1990 was missing multiple pages and Exhibit A. Per the Community Sanitation Staff they do not have a complete Contract Document nor does the local State Department of Transportation Office.

Audit Recommendation:

2. The Community Sanitation Management should immediately obtain a complete copy of the State of California's Department of Transportation's Contract dated December 31, 1990 and any additional Amendments/Exhibits to this Contract.

B. Lack of a Copy of the State Maintenance Manual:

Section D (Degree of Maintenance) of the December 31, 1990 contract states: "the degree or extent of maintenance work to be performed and the standards therefore shall be in accordance with the provisions of section 27 of the Streets and Highways Code, as set forth in the current edition of the State Maintenance Manual (a copy of which has been provided to the CITY)..." Community Sanitation does not have a copy of the State Maintenance Manual. Therefore, Internal Audit was unable to review the Manual and determine if the work being performed by Community Sanitation is in compliance with the State Maintenance Manual.

Audit Recommendation:

3. The Community Sanitation Management should immediately obtain a complete copy of the State Maintenance Manual and review the Manual to ensure Community Sanitation is in compliance with all State Regulations per the Streets and Highways Code.

C. Department Responsible for Contract Oversight Unclear:

- Portions of the State Contract document received and reviewed by Internal Audit indicate both the DPU and DPW share responsibility for compliance and enforcement of this Contract (e.g. Community Sanitation - Median Island Cleaning and Street Sweeping; Public Works - Street Lights and Traffic Signals).
- Section B (Agreement) of the December 31, 1990 contract states: "...The CITY will pay utility bills for such street lights and traffic signals include on such highways and bill to

the STATE the proportionate share as shown in Exhibit “A” attached. Exhibit “A” of the Contract is missing. Further, Community Sanitation does not have financial records to verify the City invoiced the prorated amount of Utility Bills for Street Lights and Traffic Signals on the designated SRs per Exhibit “A”. Traffic Signals are the responsibility of DPW not DPU.

- Section HM4K (Electrical) of the December 31, 1990 contract states: “... Maintenance of the “Designed” timing is the responsibility of the CITY. Timing records shall be kept in the Traffic Signal Division of the CITY.” Traffic Signals are the responsibility of DPW not DPU.
- The December 31, 1990 Contract Section titled EMERGENCY OPERATION OF TRAFFIC SIGNALS DURING EQUIPMENT FAILURE states: “A written “Contingency Plan” for operation of traffic signals shall be prepared for emergency operation of each signalized intersection. Copies of the plan shall be kept in the controller cabinet in the Traffic Signal Division of the CITY...” Traffic Signals are the responsibility of DPW not DPU.

Community Sanitation staff indicated they believe the Contract is DPW’s, not DPU’s. DPW indicated they have their own Contracts with the State Department of Transportation.

Internal Audit was unable to fully audit this State Contract (including invoicing for utility payments) based upon the above findings in A through C. Therefore, Internal Audit proposes the following recommendations:

Audit Recommendations:

4. The DPU Director and Community Sanitation Management should meet with the DPW Director and his Staff to formally determine whose Department is Contractually Responsible for this State Contract, what services the City/Department is suppose to provide, and what services are to be paid by the State or the City.
5. After recommendation 4 has been completed, DPU and DPW’s Management should determine whether to pursue and enter into separate contracts with the State. The new contracts should be for services provided only by their respective Department and reimbursable to their Department by the State. An option could also be a “tri-party” contract between the State, DPU and DPW.
6. Upon completion of recommendations 4 and 5 above, the appropriate Department’s (DPU or DPW) Management should review and verify invoicing to, and payments from, the State of California Department of Transportation for utility payments due the City.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATIONS – 2 through 6 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATIONS – 2 through 6 Dated November 24, 2010

The Community Sanitation Division contract with CalTrans expires at the end of calendar year 2010, and both agencies agree that it will not be renewed due to fact that CalTrans is relinquishing those State right-of-ways that were local streets swept by the Community Sanitation Division at the end of calendar year.

DIVISION'S FOLLOW-UP STATUS FOR RECOMMENDATIONS 2 THROUGH 6 – FULLY IMPLEMENTED

The current agreement between the City of Fresno, Community Sanitation Division (CSD) and the State of California (CalTrans) has expired for street sweeping services in designated areas as of December 2010.

On July 7, 2010, the Community Sanitation Division received an email from Kip Michelson, Contract Manager for CalTrans, stating due to the lengthy process it takes for an agreement to be completed, and the fact that CalTrans will have completed construction of State Route 180 east from Clovis Avenue to Temperance Avenue within the City of Fresno prior to December 2010, it would not be prudent to rewrite this section of the agreement.

All monies for this agreement have been received and there are no outstanding payments due to the City of Fresno.

On December 3, 2010, CSD received an email from Mr. Michelson explaining that at this time a date has yet to be determined when CalTrans will be providing us with formal documentation “voiding” the agreement. Upon receipt of the formal documentation, CSD shall forward a copy to Mr. Bob Koury.

INTERNAL AUDIT'S FINAL FOLLOW-UP COMMENT – RECOMMENDATIONS 2 through 6 – NO LONGER APPLICABLE

Community Sanitation and CalTrans are not going to renew the Agreement.

SOLID WASTE DIVISION'S REVENUE CONTRACT

III. Sunset's Agreement for Processing Services for Recyclable Materials

The DPU entered into a Contract with Sunset Waste Paper Inc. on March 20, 2000, to receive and process (at a minimum 95%) of all the recyclable materials (excluding wood and yard waste)

collected within the city limits. After receipt and sorting of the recyclables, Sunset must make a reasonable effort to sell all processed recyclable products at the highest price. The Residual Material (contaminated recyclable products or recyclable products unable to be sold) are delivered to Fresno County's Landfill or another disposal facility designated in writing by the City.

The Sunset Contract is both an Expense and Revenue Contract. Based upon contractual adjustments, revenue credits, and fees allotted to the City of Fresno, Fresno must pay Sunset the net amount for processing Fresno's recyclable materials. At the request of the DPU Director, Internal Audit audited this contract to ensure all the revenue credits, volume adjustments, and royalty payments were being properly recognized prior to payment due to the complexity of this contract. Other Contract Terms (e.g. Insurance and Surety Bond) and other contractual deliverables (e.g. Damages, Meetings, Reports, Etc.) were also audited to ensure compliance. Parts of the initial Contract entered into on March 16, 2000 were amended by the First Amendment dated April 3, 2002. The First Amendment provided greater clarification for the compensation calculations and payment by the City and deliverables due by Sunset.

Internal Audit noted the following:

A. Lack of Complete Formal Agreement and Exhibits:

Page 18 of the March 16, 2000 Agreement, Processing Services for Recyclable Materials City of Fresno, California states: "Attachments:

- Exhibit A – Reports
- Exhibit B – Proposal
- Exhibit C – Revenue Sharing
- Exhibit D – Implementation Schedule"

Internal Audit requested and received a copy of the Sunset Contract, Exhibits and Amendments dated March 16, 2000. The 2000 Agreement between Sunset and the City did not have Exhibits C – Revenue Sharing and Exhibit D – Implementation Schedule attached. Internal Audit was unable to conclude whether there were provisions in Exhibits C and D that are still valid or have been superseded by language in the First Amendment to the Agreement dated April 3, 2002. In addition, Internal Audit could not conclude whether Sunset and the City were in full compliance with the Terms in Exhibits C and D.

Audit Recommendation:

7. Solid Waste Management should obtain a copy of Exhibits C and D of the original Contract to ensure all terms of either the original Agreement and/or First Amendment are being complied with by both parties to the Contract.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 7 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

Subsequent to completion of the Audit Fieldwork and the Audit Exit Meeting held on May 26, 2010, Solid Waste Staff provided Internal Audit with a complete copy of the March 16, 2000 Sunset Contract including Exhibits C and D. EXHIBIT “C” – REVENUE SHARING states: “The City shall receive 25% of the Net Profits, where Net Profits are defined to be Operating Revenue minus Operating Expenses. A quarterly calculation shall be provided to the City that shows at least the following information:

Calculation for Quarter Ending _____2000

1. Operating Revenues
 - A. Sale of Scrap ...
 - B. State CRV Redemption ...
 - C. Tipping Fees ...
2. Operating Expenses ...
3. Net Profit/(Loss) ...

The Notes Section states: “...4. City shall only share in Net Profit, and shall not be required to share any Loss.”

Internal Audit can not conclude that the City received or is receiving the Quarterly 25% of the Net Profits since Exhibit C was not provided at the time of the initial document request. From a cursory review of Exhibit C by Internal Audit, it appears Solid Waste may not be receiving the Operating and Net Profit/(Loss) information to determine if the City is receiving the 25% Net Profits. Further, Internal Audit can not conclude whether Exhibit C was only for year 2000 and/or might be applicable to future years.

Exhibit D dealt with the building and opening of the Sunset Facility. Therefore, Exhibit D has been verified by Internal Audit due to the existence of and tour of the Sunset Facility.

INTERNAL AUDIT'S RESPONSE TO MANAGEMENT'S RESPONSE TO AUDIT RECOMMENDATION – 7

Internal Audit concurs that Management has partially implemented Audit Recommendation 7 by obtaining a copy of Exhibits C and D for the March 16, 2000 Contract. In addition, Internal Audit has verified that Exhibit D requirements were met, but Internal Audit could not verify compliance with Exhibit C. Therefore, see Audit Recommendation 8 below.

INTERNAL AUDIT'S FOLLOW-UP COMMENT – RECOMMENDATION 7- NO LONGER APPLICABLE

Audit Recommendation was initially partially implemented but is no longer applicable. See Audit Recommendation 8.

Audit Recommendation:

8. Solid Waste Management and Staff should investigate the current relevancy of Exhibit C and/or whether the 25% of the Net Profits was received in the Year 2000 and for all applicable future years during the Term of the Contract.

DIVISION'S RESPONSE TO RECOMMENDATION – 8 Dated June 17, 2010

The 1st Amendment to the Sunset Agreement dated July 1, 2003 resulted in a new calculation as shown in Exhibit D of the Amendment.

INTERNAL AUDIT'S RESPONSE TO MANAGEMENT'S RESPONSE TO AUDIT RECOMMENDATION – 8

Audit Recommendation 8 refers to Exhibit C, not Exhibit D, of the March 16, 2000 Contract. Audit Recommendation 8 addresses whether the 25% Net Profit was and/or is still being received. Internal Audit received a copy of the First Amendment dated April 3, 2002 with only Exhibits C, E, and F attached. Internal Audit did not receive an Amendment dated July 1, 2003 with any Exhibits attached.

DIVISION'S FOLLOW-UP STATUS – UNABLE TO IMPLEMENT

The 1st Amendment to the Sunset Agreement dated April 3, 2002 resulted in a new calculation as shown in Exhibit C of the Amendment. At that time the new calculations including Processing fee per ton, Volume Adjustment and Revenue Share Credit and Royalty Payment was implemented. This was verified to be fully implemented on the dates noted. The 25% of the Net Profit as stated in the Original Agreement, Exhibit C cannot be verified from March 2000 until April 2002 when the Amendment went into effect as those records were destroyed January 2009 per Record Retention Procedures.

B. Lack of Procedures for Solid Waste (SW) Drivers' Entering and Exiting the Sunset Facility and Completion of Load Tickets:

The information on the Sunset Load Tickets for vehicles entering and exiting the Sunset Facility is crucial for the accurate invoicing of expenses and revenue credits. Internal Audit noted the following:

- There are no formalized (written) procedures detailing SW Drivers' responsibilities related to Sunset Load Tickets.
- SW Drivers do not submit a Sunset Load Ticket to their Supervisor on a daily basis for each load they deliver to Sunset. Instead, a designated SW Driver picks up the available Load Tickets from the prior day during one of his daily trips to Sunset and submits those tickets to the designated SW Accounting employee responsible for the Invoice Reconciliation process prior to payment of the monthly Sunset Invoice. If the designated SW Driver is unavailable then a SW Supervisor or other designated SW employee must drive to Sunset to pick up the Load Tickets.
- All SW drivers do not legibly sign their full name on the Load Ticket.

- All SW drivers do not always enter their Route Number on the Load Ticket.
- Drivers' Supervisors do not consistently monitor and enforce SW Driver accountability and responsibility for proper completion of the Sunset Load Tickets.

The above findings prevent Sunset from submitting a "clean" invoice timely to DPU. In addition, each of the "line errors" on Sunset's initial Report to Solid Waste must be researched and corrected by a SW Accounting Employee prior to Sunset submitting an initial Invoice for payment. If the SW Accounting Employee cannot determine who the SW Driver was and their Route Number, then "69" is entered for Residential Routes and "86" for Commercial Routes to designate "Unknown". The daily Sunset Load Report submitted on 4/1/10 and reviewed by Internal Audit had a 67% error rate for SW Drivers' incomplete or missing Name and Route Number.

Audit Recommendation:

9. Solid Waste Management should develop and distribute detailed formalized procedures for all SW Drivers entering/exiting the Sunset Facility. SW Management should then monitor compliance of the procedures implemented for SW Drivers entering/exiting the Sunset Facility, especially the Driver's Signature and Route Number for accurate and timely Invoicing by Sunset and for accountability purposes.

Subsequent to completion of the Audit Fieldwork and the Audit Exit Meeting held on May 26, 2010, Solid Waste Staff provided Internal Audit with a May 28, 2010 Memo/Letter to Solid Waste Division Drivers/Helpers – Subject: Driver's Daily Duties. The first line states: Be sure to print your name legibly and write down your route number on your weight tag.

Solid Waste Management must now enforce these Policies and Procedures to prevent inefficiencies for both Sunset and Solid Waste for the Invoicing, Reconciliation, and Payment process per Contract language.

DIVISION'S RESPONSE TO RECOMMENDATION – 9 Dated June 17, 2010

DPU Management concurs. Solid Waste shall enforce Policies and Procedures set in place.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Solid Waste shall enforce Policies and Procedures set in place. This was fully implemented in May 2010. Staff received Memo on May 28, 2010 regarding printing legibly and writing down route number on tags. This is being enforced by the Chief reviewing the tags.

INTERNAL AUDIT'S FOLLOW-UP COMMENT – PARTIALLY IMPLEMENTED

Solid Waste does have a Policy regarding Drivers printing their name legibly and writing their route number on the Sunset Weight Tags. However, SW Management is not enforcing this policy as noted during follow-up test work performed.

C. Insufficient Detail on Monthly Sunset Invoices and Reports:

Section 4 of the March 16, 2000 Agreement states: “During the term of this Agreement, the CONTRACTOR shall submit to the CITY reports, ... in a form and manner approved by the CITY. The City may at anytime request additional or supplemental information ...”

The daily Sunset Ticket “Load” Report received from Sunset by DPU does not contain the total number of tickets included in that “Load”. Therefore, SW does not know how many hardcopy tickets should have been picked up by SW for a given day. If the total number of tickets for the “Load” was indicated on the Sunset “Load” Report, the initial verification process between the electronic data and the hardcopy date could be performed more efficiently.

In addition, Sunset does not include formulas used for computations on supporting monthly Revenue Sharing and Residual Reports submitted with Invoices.

Audit Recommendation:

10. Per the terms of the Contract, Solid Waste Management should formally request any additional detail or supplemental information related to invoices or records received from Sunset to more clearly reflect and adequately document all truck loads, charges, and revenue credit calculations received from Sunset.

DIVISION’S RESPONSE TO RECOMMENDATION – 10 Dated June 17, 2010

DPU Management concurs. Sunset will begin submitting spreadsheets with the formulas so that Solid Waste can verify calculations.

DIVISION’S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Sunset will begin submitting spreadsheets with the formulas so that Solid Waste can verify calculations. This was fully implemented in June 2010. Sunset is submitting spreadsheets with the formulas and Solid Waste is verifying the calculations.

D. Inability to Verify Performance and Submission of Semi-Annual Composition Studies (Comp. Studies)

Section 3.5 of the First Amendment to Agreement dated April 3, 2002 states: “The Contractor shall conduct a Composition Study of the CITY’s delivered materials in both May and October of each year of this agreement in accordance with procedures described in Exhibit F.”

Item 5 of Exhibit F – Composition Study Procedures states: “The Contractor shall provide to the CITY an analytical report by material type. The analytical report shall include weight and volume process by each material type, as well as other information that may be deemed appropriate by the CITY.”

The First Amendment to the Agreement Section 3.5 (Composition Study) states: "...Thereupon, the average of the most recent two Composition Studies will be used to determine the percentage of Residual Materials contained in the CITY's Recyclable Materials for purposes of Subsection 7.5."

Internal Audit requested Sunset's Composition Studies for 2008 through 2010. Internal Audit was provided with Solid Waste's binder with Sunset Reports submitted during 2008 to present. Internal Audit found one Result of the Bi-Annual Composition Study dated August-September 2008 which included a Cover Memo and Analytical/Graft data for the Residential Compensation Study as of 8/8/2008 and the Commercial Compensation Study as of 9/2/2008. The Cover Memo includes the percentage decrease or increase in Residual Materials which is used by Sunset to calculate and submit the Commercial/Residential Landfill Charges Invoices. The percentage decrease or increase is crucial to Solid Waste reconciliation process for the Landfill Invoice.

Subsequent to completion of the Audit Fieldwork and the Audit Exit Meeting held on May 26, 2010, Solid Waste Staff provided Internal Audit with only the Analytical/Graft portion of the 9/8/08 Residential Composition Study and the 9/1/08 and 5/8/09 Commercial Compensation Study. No Cover Memo was included which is essential to the verification of Sunset's Residential/Commercial Landfill Charges Invoice.

Audit Recommendation:

11. Solid Waste Management should enforce and monitor compliance by Sunset regarding the performance of all Compensation Studies and submission of a complete Compensation Report (including the Cover Memo and the Analytical/Grafts for the Residential and Commercial Residual Materials) for verification of Sunset's Landfill Invoice.

DIVISION'S RESPONSE TO RECOMMENDATION – 11 Dated June 21, 2010

DPU Management concurs. Solid Waste shall ensure Sunset includes a cover memo with the Compensation Report.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED – DUE MAY 2011

Solid Waste shall ensure Sunset includes a cover memo with the Compensation Report. This has been partially implemented. Sunset was notified to include the cover letter. It will be fully implemented in May 2011 when the next Compensation Report is due.

E. Inability to Verify Sunset's Landfill Charges, Base Processing Fee, Revenue Sharing Credits, Volume Adjustment, and Royalty Payment Owed to the CITY:

- ❖ Internal Audit attempted to verify a sample of Sunset's Residual Invoices for the period of June 2009 through January 2010. Solid Waste was unable to provide a copy of Sunset's semi-annual 2008 and 2009 Composition Studies. Sunset's Invoices indicated

the Residual Amount per month was over 8%. In addition, the October 2009 Sunset Residual Report was not provided to Audit. It appears Solid Waste may not have received an electronic or hardcopy of Sunset's October 2009 Residual Report. Therefore, Internal Audit can not conclude the City is being invoiced and paying the correct Landfill Charges.

The First Amendment Section 7.5 (Residual Materials) states: "...However, in the event a load of Recyclable Materials contains in excess of eight percent (8%) Residual Materials, those Materials exceeding eight percent (8%) shall be disposed of at cost and the CONTRACTOR may deduct such cost from the total amount of the CITY's credit received from Volume Adjustment, Revenue Share Credit and Royalty Payment."

In addition, Sunset is separately invoicing the CITY for Solid Waste's Residential and Commercial Landfill charges instead of deducting the charges from the Base Processing, Volume Adjustment, Revenue Share Credit and Royalty Payment Invoice. Per SW Staff, there is only one PeopleSoft account for Sunset. Therefore, even if the Landfill Charges are invoiced separately from the Processing Invoice, all Sunset charges are offset by the Volume Adjustment, Revenue Sharing Credits and Royalty Payment. Internal Audit could not verify SW's statement due to the inability to verify the Landfill and Processing Invoice amounts.

- ❖ The First Amendment to the Contract dated April 3, 2002 Section 7 (Composition subsections 7.1 through 7.4) are extremely detailed on how the Base Processing, Volume Adjustment, Revenue Share Credit and Royalty Payments are to be calculated using an annually adjusted CPI Index. The adjusted CPI Index is to be annually calculated by the City and provided to the Contractor so the new rate can go into effect by July 1st of each year.

Internal Audit attempted to verify Revenue Sharing Credits but was unable to completely verify whether the City had received the proper amount of all credits due. Internal Audit either could not verify figures used in the computation and/or noted a difference in the number reported on the Sunset Reports. From audit fieldwork performed on invoices for the months of July 2009, October 2009, and January 2010, Internal Audit concluded Solid Waste has either over paid or under paid Sunset.

Audit Recommendation:

12. Solid Waste Management should recalculate all Sunset Landfill and Base Processing charges and revenue sharing credits for all invoices from June 2009 to present to determine if Sunset has over/under charged the City. If the City has been over/under charged, the DPU Director should direct Division Management to properly pay or invoice Sunset.

DIVISION'S RESPONSE TO RECOMMENDATION – 12 Dated June 17, 2010

DPU Management concurs. Solid Waste shall recalculate invoices from June 2009 until present within the next three months.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED – DUE FEBRUARY 28, 2011

Solid Waste shall recalculate invoices from June 2009 until present within the next three months. This has been partially implemented. Sunset and Solid Waste are still reviewing. The delay has been due to working on the negotiating of the Sunset Agreement and the Commercial Franchising RFP. This should be completed by February 28, 2011.

F. Untimely and Improper Payment of Sunset Invoices by SW:

Section 7.6 (Invoicing and Payment) of the First Amendment to the Sunset Agreement states: “The CONTRACTOR shall invoice the CITY monthly...Each Invoice shall be accompanied by Weigh tickets for each Ton of material delivered to/shipped from the Processing Facility(ies)...The City will review Invoices and inform the CONTRACTOR of any disputed amounts...Payments of undisputed amount shall be made by CITY no later than forty-five (45) Working Days after the receipt of the CONTRACTOR’s detailed Invoice and required documentation by the City. Payments of disputed amounts shall be made by the CITY no later than forty-five (45) Working Days after resolution of any dispute...”

Solid Waste and Sunset are not in compliance with Section 7.6 as follows:

- a. Sunset Load Tickets do not accompany the monthly Invoice, but are picked up daily by a SW driver/employee. The monthly Load Ticket reconciliation process is ongoing from receipt of the initial Sunset Load Report until the last monthly Load Report is received and verified with each hardcopy Load Ticket.
- b. Due to the SW Drivers not properly completing the Sunset Load Tickets, Sunset is unable to issue an Invoice for payment.
- c. Solid Waste first disputes missing Load Tickets with Sunset and then requires an accurate/clean Invoice for the first and only monthly payment to Sunset versus paying the non-disputed amount and then resolving and paying the disputed amount per the Contract.

Internal Audit reviewed City payments to Sunset to determine if disputed and undisputed payments were made within 45 days of receipt of the Invoice. From the PeopleSoft Detailed Payment History By Vendor (Sunset) Report provided by Finance for the period of July 2007 through March 2010, it appears the City is paying Sunset the final net amount due within 45 days.

Audit Recommendation:

13. The DPU Director and Solid Waste Management should either amend the Sunset Contract in accordance with current Load Ticket/Report and Invoicing procedures or Solid Waste and Sunset should fully comply with Section 7.6 of the First Amendment to the Agreement.

DIVISION'S RESPONSE TO RECOMMENDATION – 13 Dated June 17, 2010

Solid Waste Management and Sunset are in the process of renegotiating the agreement. Also, there is a correction to Item b. on page 12. Sunset issues an invoice even though the drivers may not put the route number, etc. on the tickets. The tickets are reviewed prior to the invoice to make any corrections to errors/omissions on the tickets. Item c. on page 12 should read:

- c. Sunset provides Solid Waste with a monthly billing invoice. Solid Waste reviews the invoice for payment. Typically the invoice is correct and there are no disputes over the billed amount due to the fact that Solid Waste and Sunset have worked together throughout the month to reconcile any load tickets disputes, so the amount billed reflects the correct number of loads.

INTERNAL AUDIT'S RESPONSE TO DIVISION'S RESPONSE TO AUDIT RECOMMENDATION – 13

Sunset currently provides daily Excel like Reports to Solid Waste to compare and verify the Report accuracy with the Drivers' Load Tickets. Due to the incomplete Solid Waste Drivers' information, considerable time must be spent by a Solid Waste Accounting employee to research the incomplete and/or missing information prior to resubmitting the correct and complete Excel Report to Sunset. Therefore, Sunset is usually unable to generate the monthly Invoice for payment prior the tenth of the following month or sometimes later than the tenth. Section F Item b and c of our report are correctly written because an Excel like report submitted for accuracy and/or missing information is not an Invoice.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED – DUE FEBRUARY 2011

Second Amendment to the Sunset Agreement is expected to go to Council in February 2011. The language in the Amended Agreement is changed to more accurately reflect the invoicing procedure. It will be fully implemented upon Council approval of the Amended Agreement.

G. Non-Assessment of Liquidated Damages for Lack of or Untimely Submission of Required Reports:

Solid Waste does not date stamp contractually required Sunset Invoices/Reports received via mail, nor does Solid Waste retain the e-mail cover page for information submitted electronically. The March 16, 2000 Contract Exhibit A Section 1 (Monthly Project Status Reports) states: Within ten (10) Working Days after the last day of each month, the CONTRACTOR shall submit to the CITY a monthly Project Status Report..." Section 2 (Quarterly Project status Reports) states: "Within fifteen (15) Working Days from the end of each quarter, the CONTRACTOR shall submit to the CITY..." Section 3 (Annual Project Status Reports) states: Within thirty (30) Working Days from the end of each year during the term of this Agreement, the CONTRACTOR shall submit to the CITY a year-end annual Project Status Report..." Section 4 (Reports and Records Required by Other Governmental Agencies) states: "The CONTRACTOR shall procure, maintain and provide to the CITY, with the next Monthly Project Status report, copies of all

records or information which are required of the CONTRACTOR and/or CITY by any governmental or regulatory agency...”

Internal Audit reviewed the Monthly, Quarterly, and Annual Reports submitted by Sunset from 2008 to current. Internal Audit was unable to locate the January 2008 and May and June 2009 Monthly Reports. SW called Sunset and immediately obtained a copy of the three missing Monthly Reports. The SW “Responsible Party” did not know if the Reports were originally received timely but not filed or not received.

Section 19.1 A. states: “Failure to submit to the CITY any of the following reports, complete and adequate to the satisfaction of the CITY, within the specified time frames...”

1. Monthly Project Status Reports
2. Quarterly Project Status Reports
3. Annual Project Status Reports
4. Composition Studies
5. Timely Invoices...”

Section 19.1 Liquidated Damages states: “Liquidated damages may be assessed at the rate of fifty dollars (\$50.00) per event of nonperformance, per calendar day, for each calendar day after the commencements of this Agreement that the CONTRACTOR does not provide any one or more of the duties and obligations specified in this agreement...”

Per Solid Waste Staff, Sunset has rarely if ever been assessed liquidated damages. Finance provided Internal Audit with PeopleSoft Accounts Payable data for Sunset for calendar years 2008 to present. No Liquidated Damages were assessed to Sunset although, as stated above and in Section D, Internal Audit could not locate all Monthly Project Status Reports and Compositions Studies for the time period being audited.

Internal Audit was unable to conclude whether SW should have assessed Liquidated Damages against Sunset for failure to submit or timely submit documents due to the failure of SW’s staff to date stamp information received and/or maintaining a yearly Report Due Log.

Audit Recommendations:

14. The DPU Director should direct all DPU Staff to date stamp all incoming mail on the document not the envelope and/or to maintain a copy of the e-mail cover letter for documents that are time sensitive and/or require assessment of additional fees.

DIVISION’S RESPONSE TO RECOMMENDATION – 14 Dated June 17, 2010

DPU Management concurs. Staff was notified.

DIVISION’S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Staff was notified. This was fully implemented in June 2010.

15. Solid Waste Management should create a Report Log for SW Staff to enter the date the Monthly, Quarterly, or Annual Report is received to ensure timely receipt of all reports or the assessment of Liquidated Damages if Sunset is not in compliance with the terms of the Agreement.

Subsequent to completion of the Audit Fieldwork and the Audit Exit Meeting held on May 26, 2010, Solid Waste Staff provided Internal Audit with a copy of the Sunset Log starting with a February 16, 2010 entry for the Jan. Monthly Progress Report created as a result of this audit finding.

DIVISION'S RESPONSE TO RECOMMENDATION – 15 Dated June 17, 2010

DPU Management concurs and has implemented this Audit Recommendation.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Log was created. This was fully implemented in February 2010.

H. Lack of Required Insurance

The March 16, 2000 Contract Section 17.4 (Notification) states: “The policies of insurance described in Subsection 17.1 (General Liability) and 17.2 (Automobile Liability) shall be endorsed to provide an unrestricted 30-day written notice in favor of the CITY, of the cancellation of policy, or change, or reduction of coverage. The Workers Compensation policy (Subsection 17.3) shall provide an unrestricted 10-day written notice of such cancellation...”

Sunset's January 1, 2010/2011 Certificate of Liability Insurance states: “*10 Days Notice of Cancellation For Nonpayment of Premium.” Therefore, the Insurance Notification period is not in compliance with the Terms of the Contract.

Contract Section 17.4 (Notification) also states: “...The General Liability and Automobile Liability insurance policies shall be written on an occurrence form, and shall name the CITY, its officers, officials, agents, volunteers and employees as an additional insured...”

The Sunset General and Automobile Insurance Certificates do not include the City of Fresno, officers, etc as additional insured as required per the Agreement. Therefore, Sunset's Certificates of Liability Insurance are not in compliance with the Terms of the Agreement.

Audit Recommendation:

16. Solid Waste Management should formally request Sunset to comply with Section 17.4 of the Contract and instruct Sunset to submit a new Certificate of Liability Insurance for General and Automobile Insurance with the proper cancellation period and additional insured listed.

Subsequent to completion of the Audit Fieldwork and the Audit Exit Meeting held on May 26, 2010, Solid Waste Staff provided Internal Audit with a copy of Sunset's 2010/2011 Certificate of

Liability Insurance for General and Automobile and Certificate of Insurance for Workers Compensation. Neither Certificate of Insurance lists the City as an Additional Insured. In addition, the Workers Compensation Certificate of Insurance lists the Cancellation Notice as 30 days versus the required 10 day notice per the Contract.

DIVISION'S RESPONSE TO RECOMMENDATION – 16 Dated June 17, 2010

DPU Management concurs. Sunset was notified to provide Solid Waste with the correct Insurance Certificates.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Sunset provided Solid Waste with the correct Insurance Certificates. This was fully implemented. Sunset provided correct Insurance Certificates for General and Automobile showing City as additional insured. The Workers Compensation was corrected for the 10 day written notice of cancellation.

INTERNAL AUDIT'S FOLLOW-UP COMMENT – NOT IMPLEMENTED

The issues of Additional Insured's, Cancellation Notice and Workers Compensation Insurance have not been addressed per the contract language.

WASTEWATER DIVISION'S PROPERTY LEASES

The Fresno-Clovis Regional Wastewater Treatment Facility is located in southwest Fresno. Wastewater generated from homes and businesses in the metro area travels through 1,700 miles of sanitary sewer line to the Treatment Facility. The Treatment Facility process consists of two major steps: 1) Primary and Secondary Treatment, and 2) A process to treat solids removed during the process at the plant.

Treated or reclaimed wastewater is directed to 1,660 acres of ponds to percolate into the ground. A portion of the reclaimed wastewater is directly supplied to nearby farmers to irrigate crops for non-human consumption such as: Alfalfa, Corn (silage), etc.

The Director of DPU requested Internal Audit to review two Ag Farm Leases for payment and compliance in accordance with the individual Lease Agreements.

IV. Lease Agreement between the City of Fresno and Stephen and Analisa England

Effective February 1, 2007, DPU's Wastewater Division entered into a Property Lease with Stephen and Analisa England to lease one parcel (containing approximately 158 acres) to grow non-human crops. The term of the Lease is for five years with two one-year option periods.

Internal Audit's review and testing of this Lease noted the following:

A. Lack of Concise Lease Termination Date:

Article II Section A. (Annual Rental Fee and Due Date) states: "...Lessee shall pay to Lessor an annual rental fee for the Leased Premises according to the following schedule..."

APN 327-050-02T

- INITIAL TERM –
 - i. Year 2007 \$39,500 (March 1st through December 31st);
 - ii. For January 1 through February 28, 2008 through 2011 \$47,000; and
 - iii. For January 1 through February 28, 2012 \$7,900
- Option 1 - Year 2012 (March 1st 2012 through February 28, 2103) \$47,400
- Option 2 – Year 2013 (March 1st 2013 through February 28, 2104) \$47,400

The termination year for Option 1 and 2 was amended by a Side Letter dated June 20, 2007 because the initial Contract Option Term was written for 100 years not one year. Therefore, the Side Letter corrected Option 1 and 2 Contract Term Year to one year only – Option 1 to (March 1st 2012 through February 28, 2013) for \$47,400 and Option 2 to (March 1st 2013 through February 28, 2014) for \$47,400.

Article III Section A (Term) states: "The initial term of this Lease shall commence on the effective date and end February 28, 2011, whereupon and provided Lessee is not then in default hereunder this Lease shall automatically renew for up to two (2) one year option terms..."

Internal Audit noted Article II Section A (Annual Rental Fee and Due Date) language indicates Option 2 Term ends 2014 whereas the Article III Section A (Term) language indicates Option 2 ends 2013. The Term of a Lease should be consistent throughout the language of the entire Lease not vary by section of the Lease.

Audit Recommendation:

17. Wastewater Management should immediately amend this Contract to clarify the actual Termination Date of the original Lease. The Amendment should be signed by both the Lessor and the Lessee.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 17 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 17 Dated November 24, 2010

Article II Section A of the agreement contains the correct termination date. However, the date in Article III Section A contains an incorrect, conflicting date. It is apparent from review of the agreement that the intended date for Option 2 is February 28, 2014 as stated in Article II Section A and that the conflicting date in Article III Section is a clerical error.

A letter will be issued and signed by both the Lessor and the Lessee by August 1, 2010 clarifying the correct termination date for Option 2 to February 28, 2014 as stated in Article II Section A.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED – DUE FEBRUARY 2, 2011

A letter was issued on 07/19/2010 to England clarifying the correct termination date for Option 2 to be February 28, 2014 as stated in Article II Section A. The Letter was filed, copied to the city clerk's office and to public administration.

Partially Implemented: On 12/02/2010 a final copy was issued to amend this contract to clarify the actual termination date of the original lease and sent to Stephen England for his signature. The expected Date of Full Implementation is February 2, 2011.

B. Confusion Regarding Submission of Lease Payments:

Article II Section B (Place of Payment) of the February 1, 2007 Lease Agreement states: "All fee/charges due to be paid to Lessor by Lessee hereunder shall be paid to Lessor (make check payable to City of Fresno) at the address shown below or at such other address to which Lessor, by service of written notice upon Lessee may direct the payment thereof from time to time during the term hereof:

City of Fresno – Regional Wastewater Reclamation Facility
Attn: Management Analyst
5607 West Jensen Avenue
Fresno, CA 93706"

The Finance Department, not Wastewater, invoices the Lessee. The Invoice header states:

"Department of Finance
Enterprise Accounting Division
2600 Fresno Street, Suite 2156-N
Fresno, California 93721
559-621-7045"

The Invoice footer states: "Please return your remittance made payable to CITY OF FRESNO and the Duplicate Copy in the Enclosed Envelope." The service of written notice on the Invoice and the enclosed envelope both show payment is to be made to the Department of Finance not the Regional Wastewater Reclamation Facility.

Internal Audit tested eight lease payments made under the Lease effective February 1, 2007. The Lessee paid (in person) seven out of the eight payments to the Regional Wastewater Reclamation Facility versus sending the payment to the Department of Finance.

If Lease payments are accepted at Wastewater, the usual practice is to date stamp the envelope and send the sealed envelope to Finance. Finance may or may not retain the envelope with the Date Received Stamp. Lease payments made to Finance are date stamped/notated with the receipt date and a PeopleSoft Journal entry created.

Audit Recommendations:

18. Wastewater Management should amend the Place of Payment address in the Lease to be where the Invoicing and Payment Received process is performed. Upon amendment of the Lease, both Parties should sign the Lease Amendment and keep a copy for their file.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 18 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 18 Dated November 24, 2010

Article II Section B of the agreement states: “All fees/charges due to be paid to Lessor by Lessee hereunder shall be paid to Lessor (make check payable to City of Fresno) at the address shown below or at such other address to which Lessor, by service of written notice upon Lessee, may direct the payment thereof from time to time during the term hereof:”

Written notice was served to the Lessee to direct the payment to the Finance Department. This notice was served in the form of the invoice with direction to send payments to the Finance Department at the City Hall address. However, some payments continued to be direct to the Regional Wastewater Reclamation Facility and then forwarded to the Finance Department.

By August 1, 2010, per the agreement, the Wastewater Division had issued written notice directing all payments to the Finance Department at the City Hall address. The letter will clarify that no payments will be accepted at the Regional Wastewater Reclamation Facility. Since the agreement contains the language cited above allowing the written direction of payments, no amendment to the lease is necessary.

The Finance Department will be copied on the letter to ensure their understanding of the expectation that the Lessor direct all payments to the Finance Department.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Fully Implemented: A letter was issued on 07/19/2010 to England clarifying all payments should be directed to the Department of Finance, Enterprise Accounting Division at City Hall. Letter was filed, copied to the city clerk's office and to public administration.

On 07/20/2010 a copy of the letter was also provided to Finance Department for their records and to ensure their understanding of the expectation that all payments will be directed to the Finance Department.

19. All Lease Payment Instruments should be date stamped (not just the envelope) or a Cashier's Memo/Receipt should be created to document the actual date received by the City of Fresno.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 19 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 19 Dated November 24, 2010

By August 1, 2010, the Wastewater Management Division had met with the Finance Department to clarify the expectation of clearly identifying the date of the receipt of all lease payment instruments. This will include the date stamping of all instruments and/or the creation of a Cashier's Memo/receipt.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Fully Implemented: On 07/20/2010 Wastewater Management Division staff met with the Finance Department staff who issue lease invoices and process lease payments to clarify the expectation of clearly identifying the date of receipt of all lease payment instruments.

C. Non Assessment of Late Penalty(s):

Article III Section E.2 of the February 1, 2004 Lease states: "During any such holding over period, Lessee agrees to pay and shall pay to Lessor monthly rental, fees, and charges for the leased Premises, at the rate in effect at the time of the commencement of the hold over." Section E.3 states: "...any such holding over shall be subject to all the terms, covenants, conditions, restrictions...and provisions of this Agreement..." The Hold Over payment invoiced on 12/29/06 was due no later than 1/25/07 but was not paid until 1/26/07. A Late Penalty was not charged for this first monthly overdue "Hold Over" payment. Internal Audit estimated approximately \$89 should have been assessed to and paid by the Lessee.

Per Article II Section C of the February 1, 2007 Lease states: "...if the installment of rental fees is not received by the Lessor within ten (10) calendar days after the Due Date, a Late Penalty of

1.5% should be assessed for each and every day until the entire delinquent amount is received by the Lessor. “

Internal Audit noted Late Penalties were not assessed in accordance with the Lease for the following payments:

- a. The Late Penalty Fee due no later than 7/25/09 was incorrectly calculated because of the recording of two different receipt dates. Finance assessed the Late Penalty based on the earlier of the two dates. Therefore, the Late Penalty was assessed on 12 days versus 14 days.
- b. The Late Penalty for the lease payment due no later than 7/25/09 was invoiced and paid on the same day.
- c. Three lease payments were not date stamped, nor a Cashier's Memo written to provide documentation of timely payment in accordance with the terms of the Agreement. Therefore, Internal Audit could not conclude whether the payment was received timely or a Late Penalty should have been assessed.

Audit Recommendation:

20. Wastewater Management and Finance should meet to discuss the non-assessment of Late Penalties per the Lease Contract language and determine whether invoices will be re-submitted to the England's for payment of applicable Late Penalties. All subsequent Late Penalties should be assessed in accordance with the Lease.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 20 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 20 Dated November 24, 2010

As noted in the Audit Report, a late charge for the payment not received by the 7/25/09 due date was invoiced and paid on the same day. However, because two different receipt dates were recorded, Finance assessed the late penalty based on the earlier of the two dates. Because factual documentation is not available to verify that one receipt date is correct versus the other, and the difference in the late fee calculation is minor (less than \$90), it has been determined that the invoice for late fees for the payment due no later than 7/25/09 will not be resubmitted.

The audit report noted that three payments were neither date stamped nor a Cashier's Memo written to provide documentation of timely payment. Therefore, Internal Audit could not conclude whether the payment was received timely or a late penalty should have been assessed. There is also no documentation that would indicate or support the fact that the payment was received late and a penalty should be assessed. Therefore, there is no basis for submitting invoices for late fees for these payments.

As noted in the response to Audit Recommendation 19 above, Wastewater Management will clarify with Finance Department, the expectation for documenting the timely receipt of all lease payments. This will assist in the proper assessment and collection of any future late fees.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Fully Implemented: On 07/20/2010, Wastewater Management Division staff met with the Finance Department staff who issue lease invoices and process payments to ensure their understanding of the expectation that assessment and collection of late fees/penalties will continue to be enforced and further solidified with clearer date stamping procedures.

D. Lack of Required Insurance:

Per Article VIII Section A – Insurance, the England's are required to have \$1 million each for General, Auto, and Workers Compensation Insurance coverage. The England's do not carry Workers Compensation Insurance coverage. Per an e-mail sent to Wastewater by Risk Management on December 14, 2009, the indemnification and insurance provisions in City Lease Agreements will be amended. To date, an Amendment to the original England Lease for the required Workers Compensation Insurance has not been formally drafted and signed by both parties.

Audit Recommendation:

21. Wastewater Management shall meet and confer with the Risk Manager to determine if the England's must have Workers Comp. Insurance.
 - a.) If DPU Management and the Risk Manager deem the England's must have Workers Comp. Insurance as required by the Lease, DPU should formally notify the England's to obtain and provide proof of Workers Comp. Insurance within ten business days.
 - b.) If the Risk Manager deems the England's do not need Workers Comp. Insurance, then DPU Management should draft a formal written Amendment to the Lease and have both parties to the Lease sign the Amendment. Both parties should receive and retain on file a copy of this Amendment.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 21 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 21 Dated November 24, 2010

As noted in the Audit Report, the Wastewater Division received an e-mail from the Risk Management Divisions on December 13, 2009 stating the Workers Comp. Insurance requirement was not needed and as such indicated a willingness to remove the requirement. As a result of the e-mail the Lessee was not required to submit proof of Workers Comp. Insurance, however the agreement was not formally amended.

By August 1, 2010, Wastewater Management had reassessed the need for Workers Compensation Insurance and if it was determined it was necessary it would formally notify the England's to obtain and provide proof of Workers Compensation Insurance within ten business days. If it was determined the insurance is not needed, the Agreement will be amended and signed by both parties.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

A letter was issued on 07/14/2010 to England reminding him to update his insurance policy with the City. This included an updated commercial general liability insurance policy, commercial automobile liability insurance policy and worker's compensation insurance policy. Stephen England faxed the Division a copy of his commercial general and auto insurance on 07/19/2010. After reviewing England's employee situation it was determined that he had to submit in writing that he had no employees working for him. He mailed the Division a letter on 08/09/2010 stating his claims. Files were forwarded to Risk Management who approved his insurance documents.

Fully Implemented: A letter was issued on 07/19/2010 to England clarifying all insurance policies that are required every year for the term of the contract.

Section A 3 (Insurance) states: "...The liability insurance policies shall be written on an occurrence form and shall name Lessor, its officials, officers, agents, employees and volunteers as an additional insured..." England's 2007/2008 and 2008/2010 Certificates of Liability Insurance do not contain the Additional Insured clause.

Article VIII Section A states: "...The above described policies of insurance shall be endorsed to provide an unrestricted 30-day written notice in favor of Lessor, in the event of cancellation of policy, or change, or reduction of coverage, except for the Workers' Compensation policy which shall provide a 10-day written notice of cancellation..." England's 2008/2010 Certificate of Insurance does not contain the Cancellation Notice Clause.

Audit Recommendation:

22. Wastewater Management should send a written notice to the Lessee that their current Certificate of Liability Insurance does not fully comply with the Insurance Terms of the Agreement. If the England's do not cure the Certificate of Liability Insurance within 30 days, the Director of DPU should issue a Default Notice as per Article V Section B.c of the Lease.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 22 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 22 Dated November 24, 2010

Further review of documents found that the file contains a second Certificate of Liability Insurance with the appropriate Additional Insured clause and 30-day written notice in favor of the Lessor in the event of cancellation.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

A letter was issued on 07/14/2010 to England reminding him to update his insurance policy with the City. This included an updated commercial general liability policy, and commercial automobile liability insurance policy and worker's compensation insurance policy. Stephen England faxed the Division a copy of his commercial general and auto insurance on 07/19/2010. Insurance was approved by Risk Management on 08/19/2010.

Fully Implemented: A letter was issued on 07/19/2010 to England's clarifying all insurance policies that are required every year for the term of the contract.

E. Failure to Submit Required Reports:

Article I Section B.4 states: "In addition to any other reports required by law Lessee shall submit to Lessor by no later than January 10th of each year ... (i) an estimated accounting of all nitrogen supplements used on the Leased Premises, together with a listing of all fertilizers, herbicides, soil amendments, the types of crops and the amount of acreage for each during the term of this lease..." The England's have not been submitting annual reports for nitrogen supplements and all fertilizers, herbicides, soil amendments, the types of crops and the amount of acreage.

Article V B.1 (g) (Default By Lessor) states: " The failure by Lessee to keep, observe, undertake, fulfill, or perform any of the terms, covenants, conditions, warranties, agreements, obligations, and/or provisions of this Lease...where such failure shall continue for a period of thirty (30) days following service of notice thereof upon Lessee by Lessor..." Wastewater has not served written notice to the Lessee that they are in default of the Agreement.

Lack of submitting formalized (written) Nitrogen and Herbicide/Pesticide Reports, is not only a failure of the Lessee to abide by the terms of the Lease but also a failure by the City (Wastewater) to enforce the terms of the Lease. The potential for contamination of Ag Well Water is an issue of Health and Safety.

Article IX Section A. (FSA Matters) states: "Lessor and Lessee acknowledge that the Farm Service Agency of the United States Department of Agriculture ("FSA") has established contract acres...Lessee shall annually certify crops with FSA. Lessee agrees to defend, indemnify and hold the Lessor harmless from any and all losses, liability, claims and damages arising under this Section A of Article IX."

The Lessee has not provided a copy of the 2009 and 2010 FSA Reports to Wastewater. Subsequent to the audit fieldwork a copy of England's 2009 FSA Report was provided to Internal Audit. Per WW staff, the 2010 FSA Report is not yet due.

Audit Recommendation:

23. Wastewater Management should evaluate and determine if the Reporting of supplemental nitrogen and all fertilizers, herbicides, soil amendments, the types of crops and the amount of acreage grown and cultivated on City land is still required. If not, then the Lease should be amended and signed by both the Lessee and the Lessor.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 23 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 23 Dated November 24, 2010

In the past, information cited above was provided either verbally or via e-mail as necessary to meet State reporting requirements for wastewater effluent reuse. Wastewater Management has met the State mandated reporting requirements for wastewater effluent reuse for previous years and does not see value in attempting to retrieve additional data. However, by August 1, 2010, Wastewater Management had reminded the Lessee in writing of their obligations under Article I Section B.4 to submit Nitrogen and Herbicide/Pesticide reports. If future reports are not received in writing in a timely manner, Wastewater Management will utilize the mechanisms identified in Article V Section B.1 (g) to cure this lack of reporting.

The Audit Report States, "... The potential for contamination of Ag Well Water is an issue of Health and safety." Wastewater Management believes this statement is conjecture, is not based on fact relevant to this audit, is an editorial comment, and as such is not appropriate and should be removed from the report.

While the Audit recommendation does not address FSA reporting, the report notes that the Lessee has not provided a copy of the 2009 and 2010 FSA Reports to Wastewater. The report further notes that subsequent to the audit fieldwork a copy of England's 2009 FSA Report was provided to Internal Audit and that per Wastewater staff, the 2010 FSA Report was not yet due. The lease agreement does not actually contain language requiring the Lessee to provide FSA reports to the City. However, it does require the Lessee agree to defend, indemnify and hold the Lessor harmless from any and all losses, liability, claims and damages arising from FSA Matters. Therefore, as a matter of good business practice, the Division will continue to request copies of annual FSA Reports.

DIVISION'S FOLLOW-UP STATUS - FULLY IMPLEMENTED

Wastewater Management Division has reminded the Lessee in writing of their obligations under article I Section B.4 to submit Nitrogen and Herbicide/Pesticide reports.

Fully Implemented: A letter was issued on 07/19/2010 to England clarifying all accounts of nitrogen supplements used on the Leased Premises, together with a list of all fertilizers, herbicides, soil amendments, the types of crops and the amount of acreage for each. On 09/16/2010, England reported verbally to the Division all the supplements he used.

F. Lack of Written Consent to Use of Other Water Source:

Article I Section B.2 (Required Use of Effluent) states: "...If there is a need to use other source(s) of irrigation water Lessee may do so at Lessee's own cost upon Lessor's prior written consent..."

The City has not provided written consent to the Lessee to use Ag Well Water when the pH of the effluent is too high to use to irrigate the Lessee's crop(s) or a pump is broken. Wastewater has provided verbal approval to the Lessee to use Ag Water if needed during an emergency but has not provided written approval after issuing verbal consent.

Audit Recommendation:

24. Wastewater Management should evaluate and determine if written approval is necessary after verbal approval has been given during an irrigation emergency. If not, then the Lease should be amended and signed by both the Lessee and the Lessor.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 24 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 24 Dated November 24, 2010

The intent of this provision of the lease is to maximize the reuse of wastewater effluent as the irrigation water source for these properties and was therefore intended to address the long term source of irrigation water and not limit the use of other water supply in the event of a short term or emergency need. However, the literal interpretation of the language does appear to include any uses of water no matter the duration or situation. Effective immediately, any approval of the use of alternative or water supplies regardless of duration or circumstance will be provided in writing. In addition, by August 1, 2010, the Lessee had been reminded of this provision of the lease in writing and all alternative sources of irrigation water other than wastewater effluent will be locked out to prevent unapproved use. The language of future lease agreements will be modified to better capture the intent of this language.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Fully Implemented: The Wastewater Management Division determined that if the Lessee would like to use another source of water they would have to submit in writing permission to the Division's Reclamation Coordinator. Division management would then submit in writing permission for use of another source of water if it deems necessary.

V. Lease Agreement between the City of Fresno and Quist Dairy

Effective February 1, 2010, DPU's Wastewater Division entered into a Lease with Quist Dairy to lease five parcels of land (approximately 445.2 acres) to grow non-human crops. The initial term of the Lease is for five years (2/1/10 through 12/31/14) with two one-year option periods to extend the Agreement to 12/31/16.

Per Wastewater Staff, the Agricultural Year runs from October to September, not by calendar year. Therefore, Internal Audit also had to review prior Leases between Wastewater and Quist.

Prior to the February 1, 2010 Lease, Wastewater had two separate Lease Agreements with Quist Dairy. One Lease Agreement Term was February 1, 2002 through December 31, 2007 for three parcels and the other Lease Agreement Term was from January 1, 2003 through December 31, 2003 for one parcel, and January 1, 2003 through December 31, 2009 for two parcels.

Internal Audit's review and testing of this Lease noted the following:

A. Confusion Regarding Submission of Lease Payments:

Article V (Rent) of the February 1, 2002 Lease states: "...Payment shall be forwarded to the Management Analyst III, Wastewater Division, 5607 West Jensen Avenue, Fresno, CA 93706."

The Finance Department not Wastewater invoices the Lessee. The Invoice header states:

"Department of Finance
Enterprise Accounting Division
2600 Fresno Street, Suite 2156-N
Fresno, California 93721
559-621-7045"

The Invoice footer states: "Please return your remittance made payable to CITY OF FRESNO and the Duplicate Copy in the Enclosed Envelope." The service of written notice on the Invoice and the enclosed envelope both show payment is to be made to the Department of Finance not the Regional Wastewater Reclamation Facility.

Internal Audit tested 14 lease payments made under the February 1, 2002 Lease Agreement. The Lessee paid four out of the 14 payments to the Regional Wastewater Reclamation Facility in person and the remaining ten payments were sent to the Department of Finance.

Article II Section B (Place of Payment) of the January 1, 2003 and 2010 Lease states: “All fee/charges due to be paid to Lessor by Lessee hereunder shall be paid to Lessor (make check payable to City of Fresno) at the address shown below or at such other address to which Lessor, by service of written notice upon Lessee may direct the payment thereof from time to time during the term hereof:

City of Fresno – Regional Wastewater Reclamation Facility
Attn: Management Analyst
5607 West Jensen Avenue
Fresno, CA 93706”

Internal Audit tested eight lease payments made under the Lease Agreement effective February 1, 2007. The Lessee paid 17 payments from the January 1, 2003 Lease and three payments from the January 1, 2010 Lease. Two payments made under the January 1, 2003 Lease were made to Wastewater. The remaining 2003 and 2010 payments were made to Finance.

If Lease payments are accepted at Wastewater, the usual practice is to date stamp the envelope and send the sealed envelope to Finance. Finance may or may not retain the envelope with the Date Received Stamp. Lease payments made to Finance are date stamped/notated with the receipt date.

Audit Recommendations:

25. Wastewater Management should amend the Place of Payment address in the Lease to be where the Invoicing and Payment Received process is performed. Upon amendment of the Lease, both Parties should sign the Lease Amendment and keep a copy for their file.

DIRECTOR’S INITIAL RESPONSE TO RECOMMENDATION – 25 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR’S REVISED RESPONSE TO RECOMMENDATION – 25 Dated November 24, 2010

See response to Audit Recommendation #18 above.

DIVISION’S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Article II Section B of the agreement states, “All fees/charges due to be paid to Lessor by Lessee hereunder shall be paid to Lessor (make check payable to City of Fresno) at the address shown below or at such other address at which Lessor, by service or written notices upon Lessee, may direct the payment thereof from time to time during the term hereof.” Since the present agreement contains the language allowing the written direction of payments, no amendment to the lease is necessary.

Fully Implemented: A letter was issued on 07/19/2010 to Quist clarifying all payments should be directed to the Department of Finance, Enterprise Accounting Division at City Hall. Letter was filed, copied to the city clerk's office and to public administration.

On 07/20/2010 a copy of the letter was also provided to Finance Department for their records and to ensure their understanding of the expectation that all payments will be directed to the Finance Department.

26. All Lease Payment Instruments should be date stamped (not just the envelope) or a Cashier's Memo/Receipt should be created to document the actual date received by the City of Fresno.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 26 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 26 Dated November 24, 2010

See response to Audit Recommendation #19 above.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Fully Implemented: On 07/20/2010 Wastewater Management Division staff met with the Finance Department staff who issue lease invoices and process lease payments to clarify the expectation of clearly identifying the date of receipt of all lease payments.

B. Non Assessment of Late Penalty(s):

Article VI (Rent) of the February 1, 2002 Lease states: "Tenant shall pay the City rent in semi-annual installments on January 15 and July 15 of each year...A late charge penalty of 5 percent of the amount due will be immediately due and payable by Tenant for rents not received within 15 days of the due date."

Internal Audit identified three payments received after the due date (15th of month) and grace period (30th of the Month). The payments were received on 7/31/06 (for the July Payment); 2/2/09 (for the January payment); and 11/6/09 (for the July payment). No Late Penalty was assessed to and paid by the Lessee. Internal Audit estimated approximately \$3,835 should have been assessed to and paid by the Lessee.

For the January 1, 2003 Lease, Article II Section A (Annual Rental Fee and Due Date) states: "...Total annual rental fee in each year hereunder shall be due and payable in advance in two equal installments due and payable on each January 15th and July 15th hereunder..." Article II Section C (Late Payment Charge) states: "Should any installment of rental fees accruing to Lessor under the provisions of this Lease not be received by Lessor within ten (10) calendar days

after such shall be due, a late payment charge equal to one and one half percent (1.5%) of the overdue amount shall be added...”

Internal Audit identified two payments were received after the 10 day grace period. Both payments were received on 1/26/09. No Late Penalty was assessed to and paid by the Lessee. Internal Audit estimated approximately \$564 should have been assessed to and paid by the Lessee.

Audit Recommendation:

27. Wastewater Management and Finance should meet to discuss the non-assessment of Late Penalties per the Lease Contract language and determine whether invoices will be re-submitted to the England's for payment of applicable Late Penalties. All subsequent Late Penalties shall be assessed in accordance with the Lease.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 27 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 27 Dated November 24, 2010

The Audit Recommendation refers to the England's, however, the lease agreement in question is actually between the City and Quist Dairy. By August 1, 2010 Wastewater Management met with Finance to discuss the reasons late penalties were not assessed on late payments and agree on a procedure to ensure late penalties are assessed and invoiced for any payments not received by the due date. This will include notification to the Wastewater Division of any payments not received by the due date to allow tracking of any past due payments and associated late penalties.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Fully Implemented: On 07/20/2010, Wastewater Management Division staff met with the Finance Department staff who issue lease invoices and process lease payments to ensure their understanding of the expectation that assessment and collection of late fees/penalties will continue to be enforced and further solidified with clearer date stamping procedures.

Note: The Audit Recommendation refers to the England's, however, the lease agreement in question is actually between the City and Quist Dairy.

C. Failure to Provide Proof of Workers Compensation Insurance:

Article VIII Section A (Insurance) of the January 1, 2003 and January 1, 2010 Leases state: "...The following policies of insurance are required: ...Worker's Compensation: Insurance as required under the California Labor Code, ..." Quist Dairy is required to have \$1 million for

Workers Compensation Insurance coverage. The 2010 Quist Dairy Certificate of Insurance does not list Workers Compensation Insurance coverage.

Quist Dairy has not provided a copy of the 2010 – 2011 Certificate of Insurance for Workers Compensation coverage nor has Wastewater requested in writing a copy of Quist’s 2010-2011 Worker’s Compensation Insurance. Prior Quist Certificates of Insurance coverage did show \$1 million of Workers Compensation Insurance coverage.

Internal Audit was unable to conclude whether Quist Workers Compensation Insurance has been discontinued or a more recent Certificate of Insurance has not been provided to Wastewater. Subsequent to the audit fieldwork, Wastewater provided Internal Audit with a copy of Quist’s 2010 and 2011 Workers Compensation Insurance coverage.

In addition, all of Quist’s Workers’ Compensation Certificates of Insurance tested list “A 10 DAY NOTICE WILL BE ISSUED DUE TO NON-PAYMENT OF THE PREMIUM” in the Description of Operations Box, but the Cancellation Box on the Certificate of Liability Insurance states: “Should any of the above described policies be canceled before expiration date thereof, the Issuing Insurer will endeavor to mail 30+ Days written notice to the Certificate Holder...”

Therefore, the Quist Workers’ Compensation Certificates of Insurance are not in compliance with the Agreement.

Audit Recommendation:

28. Wastewater Management should monitor and track all Certificates of Liability Insurance to ensure compliance with the Terms of the Lease on an ongoing basis.

DIRECTOR’S INITIAL RESPONSE TO RECOMMENDATION – 28 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR’S REVISED RESPONSE TO RECOMMENDATION – 28 Dated November 24, 2010

By August 1, 2010 Wastewater Management had established a system to track all Certificates of Liability Insurance are current and in compliance with the terms of the lease. This system includes the use of software calendaring to issue automated reminded notices issues by the contract compliance data base managed by the City Attorney’s Office; however, this notification system has not been timely.

DIVISION’S FOLLOW-UP STATUS – FULLY IMPLEMENTED

A letter was issued on 07/14/2010 to Quist reminding him to update his insurance policy with the City. This included an updated commercial general liability insurance policy, commercial automobile liability insurance policy and worker’s compensation insurance policy.

Fully Implemented: A letter was issued on 07/19/2010 to Quist clarifying all insurance policies that are required every year for the term of the contract. All insurance forms were approved by Risk Management on 07/29/2010.

D. Failure to Submit Required Annual Reports:

Article I Section B.4 (Reporting Applications to Soil) of the January 1, 2003 and 2010 Leases state: “In addition to any other reports required by law Lessee shall submit by no later than January 10th of each year...(i) an estimated accounting of all nitrogen supplements used on the Leased Premises, together with a listing of all fertilizers, herbicides, soil amendments, the types of crops and the amount of acreage for each during the term of the Lease...” The February 1, 2002 Lease Agreement had similar language in Article II G.

At the time of the audit fieldwork, the Quist files did not contain an accounting of Nitrogen Supplements or all fertilizers, herbicides, soil amendments used on the land, the types of crops and the amount of acreage. The use of these types of products adjacent to or near treated well water could be a Health and Safety issue. Therefore, reporting is essential for appropriate monitoring.

Subsequent to the audit fieldwork, Wastewater provided Internal Audit with one Nitrogen accounting. Wastewater also provided Internal Audit with one Fertilizer/Herbicides Report for the years 2007 through 2009. Both of the reports were informal and not signed by Quist Dairy personnel.

Article IX Section A (FSA Matters) states: “...Lessee shall annually certify crops with the FSA. Lessee agrees to defend, indemnify and hold the Lessor harmless from any and all losses, liability, claims and damages arising under this Section A of Article IX.”

At the time of the audit fieldwork, Quist Dairy had not provided a copy of their 2007 and 2010 FSA Reports to Wastewater. Subsequent to the audit fieldwork, Wastewater provided Internal Audit with a copy of Quist’s 2007 FSA Report. Per Wastewater, the 2010 FSA Report is not due yet.

Audit Recommendation:

29. Wastewater Management should inform the Lessee in writing that Article I Section B.4 (Reporting Applications to Soil) and Article IX Section A (FSA Matters) of the January 1, 2010 Lease must be complied with and appropriate reports submitted timely.

DIRECTOR’S INITIAL RESPONSE TO RECOMMENDATION – 29 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 29 Dated November 24, 2010

Previously information cited above as required by Article I Section B.4 was provided either verbally, via e-mail, or in “informal” written reports as necessary to meet State reporting requirements for wastewater effluent reuse. Wastewater Management has met the State mandated reporting requirements for wastewater effluent reuse for previous years and does not see the value in attempting to retrieve additional data. However, by August 1, 2010, Wastewater Management had reminded the Lessee in writing of their obligations Article I Section B.4 to submit Nitrogen and Herbicide/Pesticide reports. If future reports are not received in writing in a timely manner, Wastewater Management will utilize the mechanisms identified in Article V Section B.1 (g) to cure this lack of reporting.

The Audit Report States: “...The use of these types of products adjacent to or near treated well water could be a Health and Safety issue. Therefore reporting is essential for appropriate monitoring.” Wastewater Management believes this statement is conjecture, is not based on fact relevant to this audit, is an editorial comment, and as such is not appropriate and should be removed from the report.

While the Audit recommendation does not address FSA reporting, the report notes that the Lessee has not provided a copy of the 2009 and 2010 FSA Reports to Wastewater. The report further notes that subsequent to the audit fieldwork a copy of England’s 2009 FSA Report was provided to Internal Audit and that per Wastewater staff, the 2010 FSA Report was not yet due. The lease agreement does not actually contain language requiring the Lessee to provide FSA reports to the City. However, it does require the Lessee agree to defend, indemnify and hold the Lessor harmless from any and all losses, liability, claims and damages arising from FSA Matters. Therefore, as a matter of good business practice, the Division will continue to request copies of annual FSA Reports.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Wastewater Management Division has reminded the Lessee in writing of their obligations under article I Section B.4 to submit Nitrogen and Herbicide/Pesticide reports.

Fully Implemented: A letter was issued on 07/19/2010 to Quist clarifying all accounts of nitrogen supplements used on the Leased Premises, together with a list of all fertilizers, herbicides, soil amendments, the types of crops and the amount of acreage for each. On 09/14/2010, Quist, reported all the nutrients that were applied.

E. Lack of Written Consent to Use Other Water Source:

Article I Section B.2 (required Use of Effluent) of the January 1, 2003 and 2010 Leases state: “...If there is a need to use other source(s) of irrigation water Lessee may do so at Lessee’s own cost upon Lessor’s prior written consent.” The February 1, 2002 Lease had language in Article II C regarding use of agricultural pumps/wells.

The City has not provided written consent to the Lessee to use other sources of irrigation water. The City has verbally approved the Lessee to use Ag Well Water when the pH of the effluent was too high for crop irrigation or if an effluent pump was not working but the crop(s) had to be irrigated.

Audit Recommendation:

30. Wastewater Management should evaluate and determine if written approval is necessary after verbal approval has been given during an irrigation emergency. If not, then the Lease should be amended and signed by both the Lessee and the Lessor.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 30 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 30 Dated November 24, 2010

See response to Audit Recommendation #24 above.

DIVISION'S FOLLOW-UP STATUS – FULLY IMPLEMENTED

Mr. Quist requested to use Ag Well Water as a source for dust control purposes and he was granted access to Ag Well #1. Written permission from the Division was granted on 07/22/2010 for the month of July, on 08/20/2010 for the month of August and 09/01/2010 for the remaining time until Wastewater Management deems necessary to lock the well again.

Fully Implemented: The Wastewater Management Division determined that if the Lessee would like to use another source of water they would have to submit in writing permission to the Division's Reclamation Coordinator. Division management would then submit in writing permission for use of another source of water if it deems necessary.

WATER DIVISION'S PROPERTY LEASES

VI. City of Fresno's Communications Site License Agreement with Cricket California Property Company

The Water Division leases land at some of their Pump Stations within the City limits to several different Mobile Communication Vendors. Cricket Communications (Cricket) leases land at six different Pump Stations throughout the City for a total of \$53,000 in annual rent.

Internal Audit noted the following:

A. Lack of Paying Lease Payments Timely:

Section 5 (b) (Rent) states: “The Rent shall become due and payable on the first day of the first month following the Commencement Date and annually thereafter. If the Rent has not been received by the Licensor by the last working day of the month in which it is due, the Licensee shall be deemed in default of this License.”

Cricket did not submit the full lease payment amount due for the six Cell Tower sites leased from the Water Division. One Cell Tower lease payment due by 6/30/08 was paid on 7/14/08 (15 days late). One Cell Tower lease payment due by 6/30/09 was paid on 7/1/09 (2 days late).

The Water Division issued Cricket a 10-Day Letter versus a Default Notice as required by the Contract for the 2008 or 2009 late payments.

Audit Recommendation:

31. Water Division’s Management should issue a Default Notice when full Lease Payments are not received on/or before the Due Date or Grace Period in accordance with the Lease.

DIRECTOR’S INITIAL RESPONSE TO RECOMMENDATION – 31 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR’S REVISED RESPONSE TO RECOMMENDATION – 31 Dated November 24, 2010

The Water Division is in the process of implementation. A copy of the draft notice was previously submitted to Audit for review. The recommendation from them was to send it to the City Attorney’s office for approval. This has not been done, but will be by November 30, 2010.

DIVISION’S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED

Partially implemented: The Water Division has finalized the draft of the Default Notice that will be issued when full Lease Payments are not received on/or before the Due Date or Grace Period in accordance with the Lease. A request for legal services will be sent to the City Attorney’s Office for review and approval as to form on January 25, 2011. To date, no late payments have been received from the Lessees.

B. Lack of Proper Insurance Cancellation Notice:

Section 12 (b) states: “...The above described policies of insurance shall be endorsed to provide an unrestricted 30-day written notice in favor of the Licensor, of policy cancellation, change or

reduction of coverage, except for the Workers' Compensation policy which shall provide a 10-day written notice..."

Cricket's Certificates of Liability Insurance state: "...it is understood and agreed that the additional insured(s) will be given (30) days written notice before any cancellation, non renewal or reduction of coverage. Cancellation for non payment of premium can be ten (10) days prior to the effective date, however such notice must be by registered mail..."

Cricket's Certificates of Liability Insurance do not specifically state 30-day written notice of cancellation is required for General and Automobile Insurance and 10-day written notice is required for Workers comp. Insurance. Therefore, Cricket is not in compliance with Section 12 (b) of the Lease.

Audit Recommendation:

32. Water Division's Management should contact Cricket in writing to have the Cancellation Language for all Insurances on all Certificates of Liability Insurance stated correctly and per the Lease requirements.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 32 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 32 Dated November 24, 2010

The Division has submitted the certification of Liability Insurance to Risk Management for review. The Division will follow-up with Risk Management to fully understand what is being requested and contact Cricket by December 15, 2010.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED

Partially Implemented: The Water Division, working with Risk Management, is fully aware of the requirements necessary in the Certificate of Liability Insurance with Endorsement of Additional Insured and has communicated the needed language to Cricket and its insurer Mark Risk and Insurance Services. Unfortunately, Cricket has been unwilling to comply with the Communications Site License Agreement dated January 28, 2005, between Cricket and the City, specifically Section 12, Indemnity and Insurance. Therefore, the Water Division will engage the City Attorney's Office to communicate with Cricket in writing, to inform them of their breach of the insurance requirements of this Agreement and that such breach constitutes sufficient cause for the City to terminate said Agreement. The Water Division, working with the City Attorney's Office, will have written communication to Cricket by February 28, 2011.

VII. Other Water Division Cell Tower Leases

As of April 2009, the Water Division has 15 additional Property Leases with multiple other mobile communication vendors (e.g. Sprint, Cingular, T-Mobile, Etc.) The annual lease payments per year total approximately \$117,963.

Internal Audit did not audit all mobile Cellular Property Leases. Internal Audit only audited the largest individual annual Cellular Vendor (Cricket).

Audit Recommendation:

33. Internal Audit recommends Water Division Management review all other Cellular Property Leases to determine if any of the issues identified above with Cricket exists with their other Cellular Vendors. If any contractual issue(s) with the other Cellular Vendors at a Leased Property is noted, Water Management should require the Cellular Vendor to cure the issue(s) per the Lease Terms.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 33 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 33 Dated November 24, 2010

The Water Division concurs with the audit recommendation. A review of all lease files is currently being conducted. Due to workload requirements, a deadline of December 31, 2010 has been established.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED

Partially Implemented: The Water Division has completed a complete review of all lease files and is in the process of communicating with its Licensees any deficiencies found. Updated Certificate of Liability Insurance with Endorsement of Additional Insured from deficient vendors are currently being requested from said vendors with a due date of February 28, 2011.

VIII. Lease and Adaptive Reuse Agreement Between City of Fresno - Fresno Convention and Visitors Bureau Regarding The Historic Fresno Water Tower

The DPU's Water Division has owned the Water Tower since December 1920. Previously, the Water Tower was used as a Water Storage facility before being vacated and sitting idle. The Water Division entered into an Agreement with the Fresno Convention and Visitors Bureau (FCVB) in December 1998 for renovation of the Water Tower by the City and FCVB to create a local Visitors Center. The Water Division provided \$70,000 out of the City's initial \$150,000 obligation to assist in the Water Tower renovation in 1998.

Internal Audit noted the following audit issues.

A. City Department Responsible for the Contract is Unclear:

Internal Audit received a current list of all Revenue Contract and Property Leases from the PARCS Department and DPU's Water Division in conjunction with our Citywide Contract Audit. Both the Water Division and PARCS Department listed the Water Tower Agreement as their Lease. The Water Tower is not a PARCS Asset nor did the PARCS Department provide any funding towards the Water Tower renovation.

Audit Recommendation:

34. DPU and PARCS Management should meet and resolve which of their Departments is responsible for the monitoring and oversight of the FCVB Lease and Adaptive Reuse Agreement for the Water Tower to establish clear responsibility and accountability for this City owned property.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 34 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 34 Dated November 24, 2010

PARCS has declined the offer to purchase the property at this time. In addition, they indicated they did not want to provide property management services. The Water Division is working with the City Attorney's Office on an interdepartmental use agreement with the Fresno Are Fax, the current occupant of the Water Tower Property. When finalized, this agreement will be presented to FAX by December 31, 2010 for their review. A meeting will be scheduled in January 2011 to discuss the proposed agreement and possibly finalize and execute.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED – DUE FEBRUARY 28, 2011

Partially Implemented: A meeting was held in January 2011 to discuss an agreement between FAX and the Water Division. FAX has agreed to keep and maintain the Water Tower Property per the Interdepartmental Use Agreement. The Water Division has resubmitted the Interdepartmental Use Agreement to the City Attorney's Office for review as to form and upon approval will submit for signature to FAX. The Water Division anticipates execution of the Interdepartmental Use Agreement by February 28, 2011.

B. Lack of Timely Rental Payments:

Section 3.1 (Base Rent) states: "Tenant will pay the City, a fixed base rent of \$1.00 annually. Rent will be payable in advance, beginning on the Delivery Date..." There is no documentation

stating what the Delivery Date is. The FCVB paid the July 06-July 07, the July 07-July 08 and the July 08 – July 09 rents on November 18, 2008. It appears that the July 06/07 and July 07/08 rents are late. Internal Audit could not conclude if the 2005 and 2006 rent payments were timely due to the lack of a Check Copy and Cashier's Memo and/or Receipt.

Section 11.2 (Default Defined) states: "The occurrence of any of the following will be a material breach and a default of this Agreement." Section 11.2.1 (Payment of Money) states: "Tenant's failure to pay rent or to make any other payment under this Agreement within 10 days of the due date."

Audit Recommendation:

35. If DPU's Water Division is deemed responsible for the FCVB Lease, then the Water Division should monitor and track all annual Lease Payments and issue a Default Notice if the FCVB does not pay timely.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 35 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 35 Dated November 24, 2010

The FCVB is no longer leasing the Water Tower Property. November 22, 2010 – PARCS has declined the offer to purchase the property at this time. In addition, they indicated they did not want to provide property managerial services. The Division is working with the City Attorney's Office on an interdepartmental use agreement with Fresno Area FAX, the current occupant of the Water Tower Property. When finalized, this agreement will be presented to FAX by December 21, 2010 for their review. A meeting will be scheduled in January 2011 to discuss the proposed agreement and possibly finalize and execute.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED – DUE FEBRUARY 28, 2011

See response to Audit Recommendation #34 above.

C. Lack of Professional Liability Insurance:

Section 8.1.5 (Builder's Risk Insurance) states: "...The general liability and auto policies will be endorsed to require an unrestricted 30-day written notice to the City of any cancellation or a change in terms or coverage..." The FCVB's General and Automobile Certificate of Liability Insurance states: "Cancellation: Ten Days Notice for Non Payment of Premium."

For Professional Insurance Coverage, Lease Section 8.1 (Insurance) states: "Tenant will maintain the following insurance policies in effect..." Section 8.1.4 (Professional Liability) states:

“insurance (errors and omissions) for the design and engineering of Tenant’s Work with a liability limit of not less than \$1,000,000 per occurrence.” At the time of the audit fieldwork, the FCVB did not have Professional Liability Insurance.

Section 8.1.5 (Builder’s Risk Insurance) also states: “...**The Tenant will furnish the City with insurance certificates and applicable endorsements for ALL required insurance before the City signs this Agreement...**” Section 11.2.3 (Other Breach of Agreement) states: “Tenant’s failure to observe and perform any other provision of this Agreement when the failure continues for 30 days after written notice from the City.”

The FCVB was in default of this Lease for failure to have all required Insurances prior to the City signing the Contract. Further, Risk Management notified the FCVB on January 26, 2010 that the FCVB must have Professional Insurance coverage which was not cured within 30 days.

On March 16, 2010, the FCVB provided Internal Audit a Certificate of Liability Insurance which included Professional Liability Insurance coverage for \$1,000,000. The Certificate was dated March 16, 2010.

Audit Recommendations:

36. Water Division Management, in conjunction with Risk Management, should require the FCVB to have their Insurance Agent amend the General and Automobile Certificates of Liability Insurance in to be compliance with Section 8.1.5 of the Lease.

DIRECTOR’S INITIAL RESPONSE TO RECOMMENDATION – 36 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR’S REVISED RESPONSE TO RECOMMENDATION – 36 Dated November 24, 2010

See response to Audit Recommendation #35 above.

DIVISION’S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED – DUE FEBRUARY 28, 2011

See response to Audit Recommendation #34 above.

Partially Implemented: The Lease between the FCVB and the Water Division has been terminated and therefore no longer applies. An Interdepartmental Use Agreement between FAX and the Water Division is in process of execution and both are City self-insured entities.

37. Water Division Management, in conjunction with Risk Management, should ensure all required Insurance is obtained prior to signing the Lease. If the Department and/or Risk

Management become aware after signing the Lease that the Lessee has not compiled with the Insurance terms of the Lease, the City should issue a Default Notice to the Lessee 30 days after the written Notice was served.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 37 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 37 Dated November 24, 2010

See response to Audit Recommendation #35 above.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED – DUE FEBRUARY 28, 2011

See response to Audit Recommendation #34 above.

Partially Implemented: The Lease between the FCVB and the Water Division has been terminated and therefore no longer applies. An Interdepartmental Use Agreement between FAX and the Water Division is in process of execution and it directs that FAX shall pay all utilities costs associated with its use of the facility prior to delinquency and that DPU will be protected and held harmless therefrom.

C. Lack of Timely Utility Payment by Lessee:

Section 7.1(Utilities) states: “Tenant will pay, defend, and hold the City free and harmless from, all charges for utility services to the Property including, without limitation, the furnishing of gas, water, sewer, electricity, telephone service, garbage pickup and disposal and other public utilities. Payment will be directly to the service provider when due and payable, and before delinquency.” Internal Audit noted the following:

- a. Utility Payments:
 - i. The 11/16/09-1/15/10 Utility payment was not paid on or before the Due Date but was paid with the next invoice.
 - ii. There was no supporting documentation (Invoice or Check) to show the City was paid for the 7/16/09 – 9/15/09 invoice.
 - iii. There was no supporting documentation (Check) to show the City was paid for the 7/16/07 – 9/15/07 invoice, although the invoice was notated paid by line item.

- a. PG & E Payments:
 - i. Two PG & E Invoices were marked Past Due.

b. Janitorial Payments:

- i. Six payments due the FCVB's first Cleaning Service were made after the Due Date (the tenth of the month).

The City of Fresno's Water Division owns the Fresno Water Tower, not the FCVB. Therefore, the City could initially be held liable for unpaid utility expenses incurred by the FCVB.

Audit Recommendation:

38. Water Division Management should require the FCVB to submit Payment of Utility documentation in a consistent and timely manner to ensure compliance with the Lease. If the FCVB does not provide Payment of Utility documentation and/or the documentation shows failure to pay timely, the Water Division should send a written Default Notice to the FCVB, in accordance with the Lease.

DIRECTOR'S INITIAL RESPONSE TO RECOMMENDATION – 38 Dated June 21, 2010

Department/Division concurs with the audit recommendation and will implement it in a timely manner.

DIRECTOR'S REVISED RESPONSE TO RECOMMENDATION – 38 Dated November 24, 2010

See response to Audit Recommendation #35 above.

DIVISION'S FOLLOW-UP STATUS – PARTIALLY IMPLEMENTED

See response to Audit Recommendation #34 above.

Partially Implemented: The Lease between the FCVB and the Water Division has been terminated and therefore no longer applies. An Interdepartmental Use Agreement between FAX and the Water Division is in process of execution and it directs that FAX shall pay all utilities costs associated with its use of the facility prior to delinquency and that DPU will be protected and held harmless therefrom.