





CITY MANAGER'S OFFICE – INTERNAL AUDIT

DATE: October 25, 2013
TO: PATRICK WIEMILLER, Director, DPU & DPW
THROUGH: RENENA SMITH, Assistant City Manager 
FROM: BOB KOURY, Principal Internal Auditor 
Budget and Management Studies Division - Internal Audit
SUBJECT: FINAL FOLLOW-UP AUDIT - LIMITED SCOPE AUDIT OF DPU & DPW
PROPERTY REVENUE LEASES - COMPLIANCE & INTERNAL CONTROLS

Attached is the Final Follow-up Review Report related to the Limited Scope Audit of DPU & DPW Property Revenue Leases issued on April 4, 2013. This audit was performed in accordance with AO 1-12 and Government Auditing Standards.

Internal Audit performed follow-up procedures, as considered necessary, and determined the current status of the original nine audit recommendations as follows:

Implemented - 1
In Progress - 5
Not Implemented - 3

We wish to thank you and your staff for your assistance during the course of this follow-up review. If you have any questions or we can be of any further assistance to your Department, please do not hesitate to contact Bob Koury, Principal Internal Auditor, at 621-7072.

Attachments

cc: Ashley Swearengin, Mayor
City Council
Bruce Rudd, City Manager
Georgeanne White, Chief of Staff, Mayor's Office
Douglas T. Sloan, City Attorney
Karen Bradley, Assistant City Controller, Finance Department
Jeffrey Cardell, Director of Personnel Services
Roy Angel, Risk Manager, Risk Management Division
Susan Derpinghaus, MAIII, DPW Administration
Craig Hansen, Supervising Real Estate Agent, DPW
Mark Johnson, Interim Facilities Manager, DPW
Pam Parr, Project Manager, DPW

Audit Scope and Objectives

The primary purpose of this limited scope audit was to determine and provide assurances that:

1. The Contractor (Lessee) and City (Lessor) have established and maintained an adequate system of internal controls to assure that all property rental/lease monies due to the City have, in fact, been received, documented, and accurately reported in accordance with the Property Lease Agreements;
2. Both Lessee and Lessor responsibilities, as stipulated and required by the property leases, have been adequately complied with by both parties to the Lease; and
3. All applicable laws, regulations, policies and procedures have been adequately complied with by the Lessee and Lessor in the performance of these Property Lease Agreements.

Audit Findings - Department of Public Utilities (DPU)

A sample of six (6) DPU property leases were selected for audit purposes. There were no audit findings or exceptions of any significance related to the internal controls and overall administration and recordkeeping of DPU's specific revenue property leases audited. The DPU Managers and their staff are all commended for their efforts and diligence in this regard.

Audit Findings and Recommendations – Department of Public Works (DPW)

A sample of ten (10) DPW property leases were selected for audit purposes. The specific audit findings related to each property lease, along with internal audit's recommendations for strengthened internal controls, enhanced property lease revenues for the City, and improved administration and monitoring for compliance by the Lessees/Tenants occupying city-owned properties, are as follows:

Marlene Feldstein, dba State Jewelry and Loan – 1249 Van Ness:

This Tenant has been paying \$1,465 on a month-to-month basis since November 2009 and is current with its rent payments as of March 15, 2013; however, there has been no rent increase in over 3 years. DPW staff *“believes that until the economy in the downtown area improves, it would be beneficial to maintain the month-to-month status of this Tenant as opposed to trying to raise the rent and lock the Tenant into a long-term lease which could result in losing the current income stream from this Tenant”*. No other audit findings related to this Tenant.

Barry Pearlstein, dba Lucky Bail Bonds – 1243 Van Ness:

This Tenant has been paying \$750 on a month-to-month basis since November 2009 and is current with its rent payments as of March 15, 2013; however, there has been no rent increase in over 3 years. DPW staff *“believes that until the economy in the downtown area improves, it would be beneficial to maintain the month-to-month status of this Tenant as opposed to trying to raise the rent and lock the Tenant into a long-term lease which could result in losing the current income stream from this Tenant”*.

Section 16 of the current property lease requires that the Tenant maintains Commercial General Liability and Workers' Compensation Insurance on a continuous basis while occupying this city-owned property. Upon request by Internal Audit for a current "Certificate of Insurance" from this

Tenant, no supporting documentation was provided to Internal Audit as evidence that the required insurance is, in fact, in compliance with this Section of the property lease with the City. This could be a significant area of risk and/or exposure to the City if, in fact, insurance coverage has expired and is not current.

Vivian Sanders, dba All About Nails – 1241 Van Ness:

This Tenant has been paying \$600 on a month-to-month basis since January 2011; however, payments to the City from this Tenant have continued to be untimely and incomplete. As of March 15, 2013, this Tenant owes the City \$205.15 in past due rent. No other audit findings related to this Tenant.

DPW staff *“believes that until the economy in the downtown area improves, it would be beneficial to maintain the month-to-month status of this Tenant as opposed to trying to raise the rent and lock the Tenant into a long-term lease which could result in losing the current income stream from this Tenant”.*

Raquel Palacios, dba Ajua Bail Bonds – 1237 Van Ness:

This Tenant has been paying \$250 per month since December 1, 2010 on unpaid rent and accrued interest since March 2007 in the sum of \$7,929.86 per a signed Promissory Note. These payments will continue through June 30, 2013. The outstanding balance due to the City under this Promissory Note as of March 15, 2013, is \$926.86. In addition, this Tenant has been paying \$600 on a month-to-month basis as its regular rent payments which have continued to be untimely and incomplete. The total outstanding balance of regular rent due to the City as of March 15, 2013 is \$416.64. Thus, the total past due and current rent due to the City from this Tenant as of March 15, 2013 is \$1,343.50.

DPW staff *“believes that until the economy in the downtown area improves, it would be beneficial to maintain the month-to-month status of this Tenant as opposed to trying to raise the rent and lock the Tenant into a long-term lease which could result in losing the current income stream from this Tenant”.*

Section 16 of the current property lease requires that the Tenant maintains Commercial General Liability and Workers’ Compensation Insurance on a continuous basis while occupying this city-owned property. Upon request by Internal Audit for a current “Certificate of Insurance” from this Tenant, no supporting documentation was provided to Internal Audit as evidence that the required insurance is, in fact, in compliance with this Section of the property lease with the City. This could be a significant area of risk and/or exposure to the City if, in fact, insurance coverage has expired and is not current.

Kocky’s Bar & Grill – 1231 Van Ness:

This Tenant has been paying \$2,000 on a month-to-month basis since March 2011; however, payments to the City from this Tenant have continued to be untimely and incomplete. As of March 15, 2013, this Tenant owes the City \$3,068.04 in past due rent.

Section 17 of the current property lease requires that the Tenant maintains Commercial General Liability and Workers’ Compensation Insurance on a continuous basis while occupying this city-owned property. Upon request by Internal Audit for a current “Certificate of Insurance” from this Tenant, no supporting documentation was provided to Internal Audit as evidence that the required insurance is, in fact, in compliance with this Section of the property lease with the City. This could be a significant area of risk and/or exposure to the City if, in fact, insurance coverage has expired and is not current.

Note: A “Stipulation for Stay of Judgment; Order” was just finalized on March 19, 2013, in the Superior Court of Fresno County stating that “Kocky’s shall pay to City, no later than Monday, April 8, 2013, all back rent owed to the City, currently totaling \$3,068.04, plus the rent for April, 2013, at \$2,000, for a total of \$5,038.04.”

Fresno Arts Council – 1245 Van Ness:

- a) There is currently no formalized and fully executed property lease between this Tenant and the City;
- b) No rent is being paid to the City by this Tenant; and
- c) This Tenant should maintain Commercial General Liability and Workers’ Compensation Insurance on a continuous basis while occupying this city-owned property. Upon request by Internal Audit for a current “Certificate of Insurance” from this Tenant, no supporting documentation was provided to Internal Audit as evidence that the required insurance is, in fact, in force. This could be a significant area of risk and/or exposure to the City if, in fact, insurance coverage has expired and is not current.

Audit Recommendations Related to the Above “Van Ness Avenue” Tenants/Property Leases:

- 1. DPW Management and the Finance Department should immediately work jointly to pursue the collection of all outstanding and delinquent rental revenues due the City from the above noted Tenants for enhanced Lease Revenues for the City.

Management’s Original 4/1/13 Response to Recommendation 1

In progress and forever ongoing. As with any property management function, the presence of outstanding and delinquent rental revenues, and the pursuit of those revenues, is a necessary part of the business. Nonetheless, progress in collections has been made. The delinquency of tenant Vivian Sanders was down to \$5.15 as of March 19, 2013, four days after the audit had identified her as being \$205.15 past due. The delinquency of tenant Raquel Palacios was down to \$37.00 as of March 27, 2013, down from the audit finding of \$416.64 on March 15, 2013, and her Promissory Note is scheduled to be paid in full by June 30, 2013. Regarding Kocky’s Bar & Grill, on March 19, 2013, the Fresno County Superior Court issued a Stipulation for Stay of Judgment stating that “Kocky’s shall pay to the City, no later than Monday, April 8, 2013 all back rent owed to the City, currently totaling \$3,068.04, plus the rent for April 2013 at \$2,000.00, for a total of \$5,068.04.” Under the guidelines of the stipulation, if at any time in the coming year rent payments become delinquent or any other item of the lease is breached by the tenant, the City will be able to proceed with the eviction process.

10/18/13 - Current Status/Response to Recommendation 1 – Implemented

As of October 16, 2013, Kocky’s, State Jewelry & Loan and Lucky Bail Bonds are all current in their rent. All continue to pay rent by the 10th of each month.

Vivian Sanders, All About Nails, is also current in her rent. She usually pays \$300-\$400 at the beginning of each month and the balance (\$200-\$300) at the middle of the month. RE Staff is agreeable for this tenant to continue to pay her rent under this agreement. She was behind in her rent from 1998 through 2010. Since that time, Staff has worked with her to not only bring her rent current during the month but added a \$100 per month increase in rent 12/1/10.

Raquel Palacios, Ajua Bail Bonds, paid off her Promissory Note as agreed on 7/9/13. She currently owes \$282.79 for the balance of her October rent. She continues to struggle paying her monthly rent and brings money in periodically during the month to pay toward the rent. RE Staff recommends continuing to allow this tenant to make her payments in this fashion.

Both Ms. Sanders and Ms. Palacios are very responsive to calls from Finance to bring in their rent when they fall behind.

2. DPW Management should follow-up with the above Tenants who do not have the required insurance coverage, in accordance with their property lease with the City, and direct them to obtain it immediately and maintain it on an ongoing basis to minimize any possible risk of loss or exposure to the City.

Management's Original 4/1/13 Response to Recommendation 2

In progress and forever ongoing. Staff has requested evidence of insurance from tenants Barry Pearlstein and Raquel Palacios, and will continue to follow up with the tenants until received. Regarding Kocky's, evidence of insurance is one of the lease compliance requirements covered in the Stipulation for Stay of Judgment (mentioned in the response to audit recommendation #1) due by April 8, 2013.

10/18/13 - Current Status/Response to Recommendation 2 – In Progress

Kocky's – Craig Hansen directed Risk to contact Kocky's agent direct. Craig has not received any information from Risk as to the status.

Ajua – there was no response from the tenant per my letter dated 3/27/13 once again requesting insurance documentation. Staff will follow up this coming week.

All About Nails – insurance expires 8/29/14.

Lucky Bail Bonds – insurance expires 1/2/14.

Arts Council – insurance expired 9/7/13. Staff will follow up for current certificate.

State Jewelry – insurance expires 1/18/14.

Real Estate Staff would like to recommend a policy be put into place to have Risk follow up on all insurance requests and requirements. Real Estate Staff only acts as a go between in requesting certificates of insurance and indemnification. Once the certificates are received by RE Staff, we are supposed to forward them to Risk for their review and approval. However, if Risk does not approve, it becomes the task of RE Staff to notify the tenant who has to notify their agent and the circle never ends. If Risk were to deal directly with the tenant and ultimately their agent, it would be a direct line process. Risk would then provide RE Staff with an approved certificate of insurance. We (RE) have no recourse when the tenant does not comply. Recourse would/could be notice to terminate tenancy and we evict the tenant for non-compliance.

Internal Audit Comment

Based on the above response and proposed recommendation by DPW Management, it is recommended that appropriate staff from DPW and Risk Management meet as soon as possible to discuss this area of concern related to the administration, monitoring and recordkeeping of the insurance requirements for all outside entities leasing city-owned property.

3. DPW Management should immediately develop, formalize and execute a current Property Lease with the Fresno Arts Council to include all appropriate and legal terms and conditions as considered necessary between both parties. This new Property Lease should be consistent with all other “Van Ness Avenue” Property Leases.
4. If DPW Management or the City Manager’s Office does not want to assess any rent to the Fresno Arts Council occupying city-owned property, this should be clearly stated in a newly developed and formalized Property Lease between the City and this Tenant.

Management’s Original 4/1/13 Response to Recommendations 3 & 4

In progress. A \$1/year lease is being developed with the Fresno Arts Council, per direction from the City Manager’s Office.

10/18/13 - Current Status/Response to Recommendations 3 & 4 – In Progress

Several months ago Staff had drafted a \$1/year lease for the Fresno Arts Council. There has been a delay due to an extended medical absence, but Staff will revive and work on completing.

AMTRAK

The current property lease between AMTRAK and the City of Fresno is a twenty year lease that commenced on November 1, 2005, and will terminate on October 31, 2025. There were no audit findings or exceptions of any significance related to the internal controls and overall administration and recordkeeping of this particular property lease. However, this Tenant does not pay any rent to the City while it occupies this city-owned property. Per DPW Facilities staff, the City “maintenance costs” incurred related to this Tenant’s facility and property is estimated at approximately \$22,000 per year.

City Hall Café (Turtle Café Effective February 4, 2013)

The previous Vendor who occupied the City Hall Café’ since September 2005 vacated the property and a new Vendor commenced operations on or about February 4, 2013, as the “Turtle Café”.

During the course of this audit, it was noted:

- a) There is not a current formalized and fully executed “Permit for Vending Facility” (Vendor Agreement) between the City of Fresno and the Department of Rehabilitation (DOR) – Business Enterprises Program (BEP) related to the current Vendor occupying the City Hall Café location;
- b) Although there is evidence that the current Vendor has Workers’ Compensation Insurance coverage, the existence of General Liability and Fire Damage Insurance coverage (to be provided by the DOR Office of Risk and Insurance Management) for the current Vendor has not been provided to Internal Audit. This situation, if not rectified immediately, could possibly put the City at risk of loss, and;
- c) The current Tenant does not pay any rent to the City while it occupies this city-owned location. Per DPW Facilities staff, City costs related to this city-owned facility in City Hall do exist but are “undeterminable”.

Audit Recommendations:

5. DPW Management should immediately complete the development and finalization of the “Permit for Vending Facility” (Vendor Agreement) between the City of Fresno and the

Department of Rehabilitation (DOR) – Business Enterprises Program (BEP) related to the current Vendor occupying the City Hall Café location.

6. In conjunction with the implementation of recommendation 5 above, the required General Liability and Fire Damage Insurance coverage (via the DOR Office of Risk and Insurance Management) related to the current Vendor occupying the City Hall location should be verified as current.

Management's Original 4/1/13 Response to Recommendations 5 & 6

The matter involving the Vendor Agreement between the City of Fresno and the Department of Rehabilitation is being investigated. Current staff has no experience or background with the matter.

7. As related to Tenants AMTRAK and the City Hall Turtle Café, who currently pay no rent for occupying city-owned properties, DPW Management should consider developing a reasonable amount of rent to be assessed both Tenants in order to help defray a portion of the City's ongoing "maintenance costs" incurred related to these two Tenants.

Management's Original 4/1/13 Response to Recommendation 7

Not implemented. The issue of whether or not tenants AMTRAK or the City Hall Turtle Café should pay rent is a policy decision that would be made by the City Manager's Office, not Public Works Management.

10/18/13 - Current Status/Response to Recommendations 5, 6 & 7 – Not Implemented

No comment – no changes from previous response.

Coffee Break Service

Since September 2008, this Tenant has leased approximately 5,200 square feet of city-owned land located southeast of the Tenant's business location at 1408 "H" Street. The leased property is used for employee or visitor parking. The Tenant currently pays the City \$100 per month in rent for this leased property and is current with its rent payments as of March 15, 2013. There were no audit findings or exceptions of any significance related to the internal controls and overall administration and recordkeeping of this particular property lease.

United Black Men (UBM)

The UBM (a nonprofit organization) has occupied the city-owned property at 1929 E. Church Avenue since 2001. This facility was abandoned by the Police Department in December 2000. The property includes a building of approximately 4,335 square feet and an enclosed parking lot.

During the course of this audit, it was noted:

- a) There has never been a formalized and fully executed Property Lease between the City of Fresno and the UBM as a Tenant in this city-owned property since they occupied it in 2001;
- b) This Tenant may or may not be maintaining adequate General Liability, Fire Damage and Workers' Compensation insurance related to this facility and the Tenant's employees and/or customers who work or visit this city-owned property. This situation, if not rectified immediately, could possibly put the City at risk of loss if the structure were damaged or destroyed, or if a UBM employee or a visiting customer were injured while on this city-owned property, and;

c) This Tenant is not assessed any rent for occupying this city-owned property totaling 4,335 square feet and an enclosed parking lot.

It should be noted that the City, for the past several years, has made attempts to rectify this problematic situation and work with the UBM to some type of resolution. However, as of the date of this audit report, the above audit findings still remain and there has been no recent activity or resolution between the City and this Tenant as yet.

Audit Recommendations:

8. DPW Management should immediately contact UBM to verify, in the interim, that they have current and adequate liability, fire damage and workers' compensation insurance in place for this city-owned facility to minimize any type of risk of loss or exposure to the City in the event of structure damage or personal injury to its occupants.

Management's Original 4/1/13 Response to Recommendation 8

Staff is renewing its attempts to contact UBM and obtain the required information and documents. However, staff has been directed in the past to not be aggressive in its efforts to bring about compliance.

9. DPW Management should proceed immediately with giving UBM sufficient notice to relocate to another location and the building at 1929 E. Church Avenue either be demolished or at a minimum, properly secured so that it cannot be accessed by any other entity or persons. Resolution of one form or another must be brought to this situation as soon as possible.

Management's Original 4/1/13 Response to Recommendation 9

The issue of whether or not to give UBM notice to relocate is a policy decision that would be made by the City Manager's Office, not Public Works Management. That having been said, staff sent a notice to UBM on March 28, 2013 to attempt to renew previous discussions regarding UBM's potential purchase of the property. Selling the property to UBM (or some other party) would be superior to paying for demolition of the property, which is estimated at about \$37,000 for hard and soft costs.

10/18/13 - Current Status/Response to Recommendations 8 & 9 – In Progress

Both these items deal with the situation with United Black Men (UBM). As to item #8, Staff has asked UBM on several occasions to provide a copy of their insurance coverage. UBM insists it has the appropriate coverage, but Staff has yet to see a copy of it that they promised to send over. Staff's last request was a month or so ago, so Staff will send out another request today. Staff has asked them four times since the last report.

On item #9, Staff met with UBM and they expressed interest in purchasing the property in "as is" condition. Back in July and into August an updated appraisal was performed. UBM agreed to the price and the parties negotiated for a few weeks over the down payment and the length of time the City of Fresno would carry a note and deed of trust. Before going to council, Staff is waiting on UBM to provide its down payment and confirm it has insurance.