

City of Miami

THEODORE GUBA, CPA, CIA, CFE
INDEPENDENT AUDITOR GENERAL



Telephone: (305) 416-2044
Telecopier: (305) 416-2046
E-Mail: tguba@miamigov.com

February 21, 2018

Honorable Members of the City Commission
City of Miami
3500 Pan American Drive
Coconut Grove, FL 33133-5504

Re: Audit of Compliance with Commercial Solid Waste Franchise Agreement – Insurance and Performance Bond/Letter of Credit Requirements
Report No. 18-02

Executive Summary

We have completed an audit of the adequacy and effectiveness of internal control policies and procedures in place at the City of Miami's Solid Waste Department (SWD) and Department of Procurement (DOP) concerning the administration, enforcement and compliance with the insurance and performance bond/letter of credit requirements of the Non-Exclusive Commercial Solid Waste Franchise Agreements (Agreement) between the City and commercial solid waste hauling companies (Franchisees). The audit primarily covered the period October 1, 2015 through April 30, 2017, and select transactions before and after this period.

Overall, we have concluded that the internal controls, policies and procedures concerning compliance with the insurance and performance bond/letter of credit provisions of the Agreement require improvement. We found that the City did not make claims of more than **\$680,000** against a performance bond prior to its expiration and the amount remains unpaid; performance bonds were insufficient to protect the public interest in the event of nonperformance; insurance coverage certificates were not updated in a timely manner; and they were not consistently calculated.

We wish to express our appreciation for the cooperation and courtesies extended to us by the SWD, DOP and Department of Risk Management while conducting the audit.

Sincerely,

A handwritten signature in black ink that reads "Theodore P. Guba". The signature is written in a cursive style with a horizontal line extending to the right.

Theodore P. Guba, CPA, CIA, CFE
Independent Auditor General
Office of the Independent Auditor General

C: The Honorable Mayor Francis Suarez
Emilio T. Gonzalez, City Manager
Victoria Mendez, City Attorney
Henry Hunnefeld, Senior Assistant City Attorney, Office of the City Attorney
Todd Hannon, City Clerk
Fernando Casamayor, Assistant City Manager/Chief Financial Officer
Alberto Parjus, Assistant City Manager
Nzeribe Ihekwebaba, Assistant City Manager/Chief of Operations
Christopher Rose, Director, Office of Management and Budget
Erica Paschal, Director, Finance Department
Munirah J. Daniel, Acting Director, Finance Department
Mario Nunez, Director, Solid Waste Department
Annie Perez, Director, Procurement Department
Ann-Marie Sharpe, Director, Risk Management Department
Vanessa Giron, Fiscal Administrator, Solid Waste Department
Members of the Audit Advisory Committee
Audit Documentation File

Audit conducted by: Paulino Garcia, Staff Auditor

Audit reviewed by: Robyn Sachs, CPA, CIA, CISA, CFE, CISSP
Information Systems Audit Administrator

**AUDIT OF COMPLIANCE WITH COMMERCIAL SOLID WASTE FRANCHISE
AGREEMENT – INSURANCE AND PERFORMANCE BOND/LETTER OF CREDIT
REQUIREMENTS**

**OCTOBER 1, 2015 THROUGH APRIL 30, 2017
Report No. 18-02**

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SCOPE, OBJECTIVES, AND METHODOLOGY

The scope of the audit was to assess and report on whether the City Solid Waste Department and the Department of Procurement complied with the terms of the Commercial Solid Waste Franchise Agreement (Agreement) and with Chapter 22 of the City's Code of Ordinances (City Code), which govern the operation of commercial solid waste collection services in the City. The audit generally covered the period October 1, 2015 through April 30, 2017.

The primary objectives of the audit were:

- To determine whether the policies and procedures in place at the City are efficient and effective in enforcing and monitoring the aforementioned requirements to protect the public's best interests.
- To verify whether all the appropriate public liability insurance and performance bonds/letters of credit were obtained as required by the City Code and the Agreement.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence in order to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit methodology included the following:

- Interviews and inquiries of appropriate personnel
- Reviews of written policies and procedures and City Code in order to gain an understanding of the internal controls
- Observations of current practices and processing techniques
- Review of the Certificates of Liability Insurance and the Performance Bonds / Letters of Credit for all franchisees
- Tests of applicable transactions and records
- Other audit procedures as deemed necessary

BACKGROUND

On September 23, 2010, the City executed a Non-Exclusive Commercial Solid Waste Agreement (Agreement) with selected firms for the period starting October 1, 2010 through September 30, 2015. An extension was granted until the new iteration of the contract for the period March 14, 2016 through March 13, 2021 was implemented. Although 13 haulers were awarded a Franchise under the 2010 Agreement; two of the haulers were purchased by other Franchisees during the period of the Agreement. The 11 haulers remaining were all granted Franchises under the 2016 iteration of the Agreement; and there were no additional franchises awarded.

The Agreement grants Franchisees the continued non-exclusive right and privilege, with related obligations, to provide regular commercial solid waste collection and disposal services, and solid waste collection and disposal services for construction, demolition and renovation sites on a contracted basis.

Pursuant to the Agreement and the City Code, the following Insurance and Performance Bonds are required:

- Insurance: Franchisee must maintain a public liability policy in the minimum amount of \$1,000,000; and an automobile liability insurance policy covering franchisee's operations with a combined single limit of \$1,000,000 per occurrence for bodily injury and property damage liability. Franchisee's certificate shall also include workers' compensation coverage. The City shall be listed as an additional insured for liability.
- Performance Bond: Franchisee agrees to maintain, for the term of the Agreement, a Performance Bond, executed by a surety company duly authorized to do business in the State of Florida, which shall be counter-signed by an agent for the company. The amount of the bond shall be the greater of \$25,000 or the franchisee's previous 12 months' franchise fees paid to the City.

Also, the Agreement requires notification to the Director of the Solid Waste Department by Certified Letter within five business days after any significant changes in the ownership of the Franchisee, its officers, directors or personnel.

AUDIT FINDINGS AND RECOMMENDATIONS

Overall, we have concluded that the internal controls, policies and procedures concerning compliance with the insurance and performance bond/letter of credit provisions of the Agreement require improvement. We found that the City did not make claims of more than **\$680,000** against a performance bond prior to its expiration and the amount remains unpaid; performance bonds were insufficient to protect the public interest in the event of nonperformance; insurance coverage certificates were not updated in a timely manner; and they were not consistently calculated.

Details of our findings and recommendations follow:

FINDING 1: CLAIMS AGAINST A PERFORMANCE BOND OF MORE THAN \$680,000 WERE NOT MADE PRIOR TO ITS EXPIRATION AND CONTROLS OVER CHANGES IN FRANCHISEE OWNERSHIP ARE LACKING

According to Article XIII, Assignability of the Agreement, “‘assignment’ shall include any transfer of a majority of stock in a FRANCHISEE or any significant change in ownership or control of the FRANCHISEE, its officers, directors or personnel. The Director of the Department of Solid Waste must be notified of any sale of a majority of stock in the FRANCHISEE and any significant changes in the ownership of the FRANCHISEE, its officers, directors or personnel by Certified letter no later than five (5) business days after such action. If assignment is granted, the new FRANCHISEE will assume all obligations set forth in the AGREEMENT and immediately comply with all terms of the AGREEMENT. If the CITY approves assignment of this AGREEMENT, it may be conditioned on the proposed assignee demonstrating fiscal solvency, reliability, and responsibility.”

On January 8, 2016, franchisee Southern Waste Systems, LLC (SWS) sold substantially all of its assets to franchisee Waste Management, Inc. However, SWS did not notify the City of the sale within five days as required by the Agreement. The SWD stated that the only notification of the sale was provided on March 3, 2016 (from the buyer) and that SWS owes the City \$440,332 in unpaid Franchise Fees (due from October 2015 through April 2016). Additionally, SWS did not pay the amounts due as a result of two audits, \$129,237 and \$49,068, covering the periods October 1, 2012 through September 30, 2013, and October 1, 2013 and September 30, 2014, issued on August 12, 2016 and September 13, 2016, respectively.

The SWD Director revoked SWS’s franchise on March 30, 2016 due to their noncompliance with the Agreement and the City Code, and sent formal legal requests in May and July 2016 to the Office of the City Attorney (OCA) asking that the OCA pursue collection of amounts owed by SWS. Accordingly, the OCA created two files (16-1450 and 16-2117) to pursue collection.

The OCA and SWD confirmed that SWS maintained a performance bond in the amount of \$1,400,000, which had an expiration date of September 30, 2016. However, claims against SWS’ performance bond were not made in advance of the bond’s expiration. As a result, SWS still owes the City **\$681,637** (\$440,332 + \$129,237 + \$49,068, as described above) plus any accrued interest and late fees.

RECOMMENDATION 1.1: SOLID WASTE DEPARTMENT

The SWD should enhance its control procedures over enforcement and compliance with Article XIII Assignability of the Agreement. Each Franchisee is required to submit a completed and notarized Monthly Report.

We recommend that the SWD update the Monthly Report to include an attestation statement as to whether the Franchisee has purchased another Franchisee or its assets, and if any of the sales or transfer criteria specified in Article XIII, Assignability of the Agreement, have been met during the applicable monthly reporting period, and require documentation supporting an affirmative response. This information should be used to assist the City in deciding whether to approve an assignment of an Agreement.

Additionally, as the SWD monitors remittance of the Monthly Report, we recommend they act under Article X Right to Terminate and/or Transfer Agreement within 30 days if haulers do not submit the report, and the Franchise Fees owed, by the due date under the Agreement.

- **Auditee Response:** In March 2016, the Department of Solid Waste inadvertently discovered that Southern Waste Systems, LLC was purchased by Waste Management. Consequently, on March 17, 2016, the Department of Solid Waste sent a letter to Southern Waste Systems, LLC (SWS) requesting documentation to verify that Waste Management purchased SWS.

On March 30, 2016, the Director of Solid Waste revoked the Franchise Agreement between SWS and the City for Commercial Solid Waste Hauling and declared null and void pursuant to Section 22-57 of the City's Code. Furthermore, Southern Waste Systems, LLC did not appeal the revocation.

On May 25, 2016, the Department of Solid Waste submitted a legal services request to default and recover solid waste franchisee monies owed by the SWS as stipulated in 2010-2016 Franchise Agreement. In addition, on July 26, 2016, the department submitted a second legal services request for the City to call on the letter of credit or make a demand on the performance bond for Southern Waste Systems (SWS).

- **Implementation Date:** The web based portal to help track monthly reports from franchise waste haulers has been implemented.

The portal currently does not have the attestation statement option as to whether a permitted Franchisee has purchased another waste hauling company or its assets, and if any of the sales or transfer meets the stipulations as specified in Article XIII Assignability of the Agreement. This will be a requested from the IT Department as an enhancement.

RECOMMENDATION 1.2: OFFICE OF THE CITY ATTORNEY

We recommend that the OCA work with the appropriate City departments to determine the current amounts owed by SWS and to pursue collection. We also recommend that the OCA implement internal controls to ensure that collection efforts, including claims against a commercial solid waste hauler's performance bond, are made in a timely manner (i.e., before bond expiration) upon notification that monies are owed to the City.

- **Auditee Response:** We have finalized demand letters to SWS (name has been changed to LGL Systems, LLC) and Waste Management Inc. of Florida. The sums due will be collected from the Franchisees directly. All claims are well within the statute of limitations. All previous collection efforts against Franchisees have successfully been completed in this manner.

In this case, two LSRs were generated for essentially the same legal service from separate attorneys. Going forward, the OCA will ensure that all LSRs are expeditiously addressed and closed to avoid confusion over the continuing need for the service requested.

- **Implementation Dates:** The demand letters are awaiting authorization to be sent. The Director of the Department of Solid Waste, the Auditor General and a member of the OCA will meet with the City Manager to discuss issues related to Franchisee audits and collections. The demand letters will be sent after that meeting.

OCA monitoring of LSR close-outs has been instituted.

FINDING 2: THE CITY'S MANAGEMENT OF THE PERFORMANCE BOND/LETTER OF CREDIT REQUIREMENTS EXPOSED THE CITY TO POTENTIAL RISK OF NONPAYMENT OF FRANCHISE FEES

In 2016, a new Agreement took the place of the 2010 versions of the Agreement – both had the following clause regarding performance bonds in Article VII, Insurance and Bonds, paragraph 7.2 “Franchisee agrees to maintain, for the term of this Agreement, a Performance Bond, executed by a surety company duly authorized to do business in the State of Florida, which shall be countersigned by an agent for the company, resident in the State of Florida. The amount of the bond shall be equal to the Franchisee’s previous 12 month franchise fee paid to the City (including the annual franchise fee, monthly 24% franchise fee, annual per account fee, and any other franchise fees paid to the City) or a minimum of \$25,000, whichever is greater, as security for the faithful performance of the Franchise Agreement. The Performance Bond shall be submitted to the Purchasing Department no later than ten (10) business days after approval of the Agreement by the City Commission and prior to the execution of the Agreement.”

The purpose of a performance bond is to provide assurance that the City will not sustain a loss but have the equivalent of full performance by each Franchisee and receive the benefit of its original bargain – performance of the underlying Agreement. A performance bond provides available funds to complete each Franchisee’s contract should the Franchisee be in default of the performance it owes the City; letters of credit have the same purpose.

Other significant areas of the 2010 and 2016 Agreements were similar; however, the City’s Department of Procurement, with acceptance by the City, asserted that since the 2016 iteration of the Agreement was new, that “there was no prior year’s volume [of Franchise Fees] to measure”, and thus the City required all Franchisees post performance bonds/letters of credit of the minimum of \$25,000.

The potential exposure (i.e., loss) to the City as a result of reducing the bond required to the minimum was **\$14,725,731** (fiscal year 2016 actual franchise fees of \$15,000,731 less \$275,000 in performance bonds) based on the information in the table below.

<u>Hauler Name</u>	<u>Fiscal Year 2015 Actual Franchise Fees</u>	<u>Bond Required During First Year of 2016 Agreement</u>	<u>Fiscal Year 2016 Actual Franchise Fees</u>
Bicon S&S National Waste	\$449,953	\$25,000	\$786,466
Eastern Waste Systems	505,938	25,000	988,523
Great Waste Recycling	141,318	25,000	141,804
J&M Scaffolds of Florida	15,289	25,000	29,470
Load It Away	35,164	25,000	58,412
Lopetra Corporation	228,700	25,000	196,712
Progressive Waste Solutions	4,953,767	25,000	5,365,181
Pronto Waste Services	17,209	25,000	20,764
Sunshine Recycling Services	83,515	25,000	102,841
Waste Management	5,806,781	25,000	7,151,091
World Waste Recycling	21,001	25,000	159,468
Total	\$12,258,635	\$275,000	\$15,000,731

Because all 11 haulers granted an Agreement in 2016 were continuing haulers from the 2010 iteration of the Agreement; and because key terms of the Agreement remained unchanged from 2010, including the service areas, service account types, and monthly Franchise Fee rate of 24% of Gross Receipts, the amount of Franchise Fees to be remitted to the City under the Agreement was estimable and foreseeable. Although no haulers defaulted on their obligations corresponding to services provided during the time the \$25,000 performance bonds were in effect, requiring each Franchisee to post only the minimum bond regardless of prior performance under the Agreement exposed the City to the potential loss indicated in the table above.

RECOMMENDATION 2: SOLID WASTE DEPARTMENT

In order to ensure that the public interest is adequately safeguarded against non-performance of the Agreement by the Franchisees, the City should require that all haulers continuing from one iteration of the Agreement to the next (i.e., all 11 haulers granted a 2016 Franchise were continuing from their Franchise granted under the 2010 iteration of the Agreement) post a performance bond or letter of credit equal to their prior fiscal year's total Franchise Fees remitted to the City, should applicable Agreement terms be similar. The SWD should communicate this requirement to the Department of Procurement prior to development and deployment of the next iteration of the Agreement.

- **Auditee Response:** The Solid Waste Department (SWD) is in agreement with the Office of the Auditor General (OAG) that Franchisees that are granted a new contract and are a current or prior year contract holder are to have their bond calculated based on the last year of fees paid to the City.

SWD agrees that without performance bonds of sufficient dollar value and quality as required by the Agreement, the public interest could be harmed if a Franchisee defaults on its obligations to the City.

- **Implementation Date:** All franchise waste bonds' amounts now are based on last year's fees paid and therefore, this issue has been corrected.

The next iteration of the contract on March 16th, 2021 will require that the performance bond be based on the prior fiscal year's remittances.

FINDING 3: UPDATE PROCEDURES TO CALCULATE PERFORMANCE BOND/ LETTER OF CREDIT REQUIREMENTS BASED ON PRIOR FISCAL YEAR FEES

Written policies and procedures are a means for businesses and other organizations to formally set out what they intend to do and the means by which they will carry out the stated objectives.

The SWD's procedure for calculating the dollar amount of the performance bond/letter of credit is based on the total Franchise Fees remitted in the prior fiscal year. However, we found that the DOP was independently calculating the amount of Franchise Fees based on a different 12-month prior period. As a result, differing dollar amounts for the surety requirement were calculated, with two haulers, as described in Finding 4, having performance bonds that were insufficient by as much as \$9,652.

We requested and obtained the SWD's written policies and procedures concerning monitoring and enforcement of the Agreement. We found that the SWD's "Standard Operating Procedures – Fiscal Division" document did not address this procedure, and the document was still in draft format since being prepared on July 7, 2016 and it had not been reviewed or formally approved by SWD management as of the end of our audit fieldwork. Without carefully considered and correctly implemented policies and procedures, there is a heightened risk of an organization making errors or failing because of a lack of focus, and losing institutional knowledge with employee turnover.

RECOMMENDATION 3: SOLID WASTE DEPARTMENT

The SWD should continue to coordinate with the DOP to ensure that they utilize the same methodology to calculate the amount of the performance bond / letter of credit required from each Franchisee. Because the SWD is the process owner, they should calculate the amount of the required performance bond at the start of each fiscal year based on the prior fiscal year's total Franchise Fees remitted, then communicate those amounts to the DOP.

The SWD management should review the draft Standard Operating Procedures – Fiscal Division document and update and formalize the document to reflect the current operating environment.

- **Auditee Response:** The SWD management will review the draft Standard Operating Procedures (SOP) – Fiscal Division document and if necessary, update the document to reflect the current operating environment where applicable.

As a matter of policy the SWD adheres to the stipulations in the contractual agreement between the City of Miami and the Franchisees and uses the stipulation as a guide for monitoring the contract. As such, the SWD has always determined the performance bond amount as stipulated by the contract, Section 7.2.

- **Implementation Date:** Ongoing. SWD will continue to assist the Procurement Department in calculating the bond amounts.

FINDING 4: INSUFFICIENT PERFORMANCE BONDS/LETTERS OF CREDIT

Article VII, Insurance and Bonds, Paragraph 7.2, of the Agreement states, “the amount of the bond shall be equal to the Franchisee’s previous 12 month franchise fees paid to the City (including the annual franchise fee, monthly 24% franchise fee, annual per account fee, and any other franchise fees paid to the City), or a minimum of \$25,000, whichever is greater, as security for the faithful performance of the Franchise Agreement. The surety shall have a rating classification of “A-” and a financial category of Class V.”

Our test of compliance with these requirements disclosed the following:

- **The Bicon, Inc.** performance bond was \$776,814 rather than \$786,466 for fiscal year 2016 (short by \$9,652).
- **The J&M Scaffold of Florida** performance bond was \$25,000 rather than \$29,470 for fiscal year 2016 (short by \$4,470).
- **Pronto Waste Services** obtained a bond from Lexon Insurance Company which has a rating of BB++, which is below the minimum A- rating required by the Agreement.

We noted that the Department of Procurement was calculating the performance bonds based on a 12-month period from the contract start date, while the Solid Waste Department stated that the policy was to calculate the bond amounts by fiscal year; the discrepancies above were noted by comparing the bonds in place at the time of audit fieldwork (July 2017) to the total franchise fees remitted during fiscal year 2016 (through September 30, 2016). Without performance bonds of sufficient dollar value and quality as required by the Agreement, the public interest could be harmed if a Franchisee defaults on its obligations to the City.

RECOMMENDATION 4: DEPARTMENT OF PROCUREMENT

We recommend that the Department of Procurement coordinate with the Solid Waste Department to establish the measurement period for performance bonds and request increases in performance bond amounts, if needed. We also recommend that the Department of Procurement review the Agreement and ensure that Franchisees’ performance bonds and letters of credit meet the Agreement’s quality requirements.

- **Auditee Response:** The effective date of the Franchise Agreements for RFQ 495344 is March 14, 2016. As it relates to the first year of the agreement, pursuant to RFP 495344, specifically Section 2.16, Performance Bond Requirements:

"The amount of the bond for the first year of the contract shall be no less than \$25,000.00 as security for the faithful performance of the franchise Agreement. The amount of the bond for the second year and throughout the remaining years of the contract, including renewals and extensions thereof, shall be equal to the Qualified Proposer's previous 12 month franchise fees paid to the City (including the annual franchise fee, monthly 24% franchise fee, annual per account fee, and any other franchise fees paid to the City), or a minimum of \$25,000, whichever is greater."

Further this Section also states that "During the term of the contract, including renewal and extension periods the Performance Bond shall be submitted annually, prior to the anniversary date of the contract."

Notwithstanding the above language, after the first year of the contract we were advised by Solid Waste that it would make better business sense to have the Bonds submitted on a fiscal year basis, instead of on the anniversary of the Agreement.

In order to accommodate this request Procurement sent letters to the Franchisees on September 21, 2017 notifying them of the change from anniversary date to fiscal year. This meant recalculating the amounts of the previous 12 month periods. All dollar amounts provided to the Franchises come from the Solid Waste Department, as Procurement does not house the data. The dollar amount were subsequently provided by Solid Waste, and all Franchisees were notified by letter on November 3, 2017. All of the bonds received were either for the amount or higher than we advised the Franchisees.

Our test of compliance with these requirements disclosed the following:

- **The Bicon, Inc.** performance bond was \$776,814.
- **The J&M Scaffold** of Florida performance bond was \$26,000.

As it pertains to the rating of **Pronto Waste Services** performance bond, we solely rely on the expertise of the Risk Department to guide us in accepting or denying the bonds received.

- **Implementation Date:** Procurement agrees 100% that without performance bonds of sufficient dollar value and quality as required by the Agreement, the public interest could be harmed if a Franchisee defaults on its obligations to the City. Because of the letter sent to the Franchisees, they have all agreed to the bond payments based on the fiscal year versus the anniversary dates, and this has already been implemented, based on the dollar amounts provided by Solid Waste department.

The Procurement Assistant, has already created a report that is used internally to track said bonds.

Effectively immediately, Procurement will confirm with Solid Waste that the dollar amounts are correct or whether they need to be increased.

FINDING 5: EXPIRED CERTIFICATES OF INSURANCE

The Agreement states in Article VII, Insurance and Bonds, paragraph 7.1 “FRANCHISEE agrees to maintain, for the term of this AGREEMENT, a public liability policy in the minimum amount of \$1,000,000; automobile liability insurance policy covering FRANCHISEE’S operations with a combined single limit of \$1,000,000 per occurrence for bodily injury and property damage liability. FRANCHISEE’S certificate shall also include workers’ compensation coverage. The City shall be listed as an additional insured for liability, and shall maintain any and all insurance as required by the terms of this AGREEMENT or as required and approved by the City’s Department of Risk Management.”

Our review of the Franchisee’s certificates of insurance showed that six of 11, or 54%, had recently expired and were in the process of being updated by the Department of Procurement.

RECOMMENDATION 5: DEPARTMENT OF PROCUREMENT

The Department of Procurement should request that the affected Franchisees update their insurance certificates. Additionally, we recommend that the Department of Procurement ensure that the City reminds Franchisees to update insurance certificates prior to their expiration.

- **Auditee Response:** Upon audit inquiry the insurance certificates were being updated. All insurance in our possession are up to date. Keep in mind that the effective dates on the Certificate of Insurance may fluctuate for the varying coverages. We have supplied a sample of how we track, and the letter that goes out to the vendor as a coverage expires.
- **Implementation Date:** Implemented.