

2010-2011
SAN BERNARDINO COUNTY
GRAND JURY



FINAL REPORT

THE 2010-2011 GRAND JURY
FINAL REPORT
IS
DEDICATED TO MEMBER

BRAD KUIPER



1938 ~ 2011

The Grand Jury suffered a great personal loss with the passing of Brad Kuiper.

Brad was serving on his fourth Grand Jury.

He was foreman of the 2005-2006 Grand Jury.

Brad was quiet and unassuming, but we discovered early on that Brad had a deep understanding of the workings of the Grand Jury and was able to share it with us and give advice and opinions that helped guide us. We came to respect and depend on him in our day-to-day work. He became our “go to guy.”

Shakespeare wrote the following which describes Brad very well:

*“His life was gentle
and the elements so mixed in him,
that nature might stand up
and say to all the world
This Was a Man.”*



Rest in Peace, Brad



COUNTY OF SAN BERNARDINO

GRAND JURY FINAL REPORT



2010-2011

EDITORIAL COMMITTEE

Robert R. Dunlap, Chair

Allen “Skip” Burt

Ever Marie James

Kent Fogleman

Margaret Furman

Susan Brewster

Wayne L. King

The Editorial Committee acknowledges and thanks the following individuals for their hard work and invaluable assistance in the preparation of the Final Report of the 2010-2011 San Bernardino County Grand Jury.

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GRAND JURY

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COUNTY OF SAN BERNARDINO

June 30, 2011

Honorable Douglas M. Elwell, Presiding Judge
Superior Court of California, County of San Bernardino
303 West 3rd Street, 4th Floor
San Bernardino, CA 92415-0302

Dear Judge Elwell:

On behalf of the 2010-2011 Grand Jury, I am pleased to present this Final Report to you and to the San Bernardino County Board of Supervisors, and to the citizens of San Bernardino County.

I would like to state that this Grand Jury believes that the vast majority of San Bernardino County employees are truly dedicated servants who strive to be the best at their jobs. Department Heads and Department Supervisors were very cooperative and helpful in allowing the Grand Jury to understand how their departments function. We were impressed with their knowledge and dedication.

I would especially like to thank Chief Executive Officer Greg Devereaux and the Board of Supervisors who were extremely cooperative with the Grand Jury. This year witnessed an administrative change, when the County Administrative Officer became the Chief Executive Officer. I feel this will be a very positive step in bringing a more ethical and moral transparency to our county.

Our Final Report could not have been completed without the legal expertise of our Grand Jury Legal Advisor, Charles Umeda, and our Grand Jury Assistant, Melonee Vartanian, who gave us guidance and advice throughout the year. A special "thank you" and a "job well done" go to Nellie Jamie, who filled in for Melonee for several weeks during her absence.

On July 1, 2010, we were 19 individuals interested in making a contribution to the county. All of us had some idea as to what should be done, and there were a number of different approaches as to how we would ultimately get the job done. We began the process of learning to work together and becoming a team. We accomplished this goal and were soon forged into a purposeful, informed team that produced the attached Final Report.

Last year's Grand Jury challenged each and every member of our county and city governments, especially the elected officials, to investigate their own departments and work toward erasing the negative image that San Bernardino carries. We stood behind this challenge and issue the same challenge again this year. We continued to investigate two entities that were initially investigated by the past Grand Jury. For the first time in the history of the San Bernardino County Grand Jury, several jury members were held over for a second year to continue their investigations. I strongly recommend that the incoming Grand Jury continue to follow up on these and other investigations.

I note with great satisfaction that the Board of Supervisors has agreed to forego their annual discretionary funds and move them back into the General Fund. The 2009-2010 Grand Jury recommended this change in the Final Report.

Honorable Douglas M. Elwell, Presiding Judge
Superior Court of California, County of San Bernardino
Page 2
June 30, 2011

Like past grand juries, this year's Grand Jury was passionately concerned about the County's "culture of corruption" image. District Attorney Mike Ramos' continuing investigations into the Colonies scandal is most encouraging and helpful in the ongoing fight against corruption. We applaud his efforts and wish him success as he presses forward in his pursuit of justice.

This year, the Grand Jury looked into some distant, rural areas of our county, and with the assistance from the CEO and the Board of Supervisors we were successful in starting a dialogue between the county and these rural communities that will be helpful to both parties.

Sadly, during our term, we lost a valuable member of our jury. Brad Kuiper passed away suddenly on February 4, 2011. Brad had been on several past grand juries and had served as foreman once. He was an intelligent, dedicated man who possessed the ability to summarize complicated information and put it into an understandable format. He was also a good friend to the jurors and was the epitome of a true gentleman. He is missed by all of us.

To my fellow Grand Jurors, it has been a learning experience for me. Your wisdom, diligence, intelligence, and search for the truth make me very proud to have served with each of you. I owe a special debt of gratitude and thanks to Foreman Pro Tem Wayne King, for his continued support throughout the year.

It has been a distinct privilege to serve as Foreman for the 2010-2011 Grand Jury, and I thank you, Judge Elwell, for selecting me as the Foreman.

Respectfully,

A handwritten signature in black ink, appearing to read "Robert Dunlap", written in a cursive, flowing style.

Robert Dunlap, Foreman
2010-2011 San Bernardino County Grand Jury

2010-2011 GRAND JURY SAN BERNARDINO COUNTY

Robert R. Dunlap	✧	Foreman
Wayne L. King	✧	Foreman Pro Tem
JoAnn L. Miller	✧	Secretary
Julie C. Crites	✧	Assistant Secretary
Allen “Skip” Burt	✧	Sergeant-at-Arms
Arnim Belke	✧	Assistant Sergeant-at-Arms

Arnim Belke	✧	Highland
Susan Brewster	✧	Alta Loma
Allen “Skip” Burt	✧	Alta Loma
Alfred J. Dubiel	✧	Ontario
Robert R. Dunlap	✧	Apple Valley
Kent Fogleman	✧	Redlands
Becky Fults	✧	Colton
Margaret Furman	✧	Hesperia
James Goodrich	✧	Ontario
Miguel Ibarra	✧	Fontana
Ever Marie James	✧	Colton
Wayne L. King	✧	Apple Valley
Duane Mellinger	✧	Highland
JoAnn L. Miller	✧	San Bernardino
Bob Mitchell	✧	Colton
Dawn Molumphy	✧	Redlands
Melinda O’Connor	✧	Victorville
Sylvia Olson	✧	San Bernardino

James Cook	✧	Chino Hills	✧	Resigned - July 2010
Clifford DeVost	✧	Rialto	✧	Resigned - September 2010
Daniel Jeffs	✧	Apple Valley	✧	Resigned - September 2010
Brad Kuiper	✧	Apple Valley	✧	Deceased – February 2011

Presiding Judge	✧	Douglas M. Elwell
Legal Advisor	✧	Charles Umeda
Grand Jury Assistant	✧	Melonee A. Vartanian

2010-2011 GRAND JURY SAN BERNARDINO COUNTY



Back row (left to right): Arnim Belke, Kent Fogleman, Susan Brewster, Becky Fuels, Melinda O'Connor, Sylvia Olson, Dawn Molumphy

Center row (left to right): James Goodrich, Margaret Furman, Ever Marie James, Duane H. Mellinger, Bob Mitchell, Miguel A. Ibarra, Alfred J. Dubiel

Front row (left to right): Allen "Skip" Burt, JoAnn L. Miller, Robert R. Dunlap (foreperson), Wayne L. King



Honorable Douglas M. Elwell,
Presiding Judge



Melonee Vartanian, Grand Jury Assistant
Charlie Umeda, Legal Advisor



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ADMINISTRATIVE COMMITTEE

Melinda O'Connor, Chair

Arnim Belke

Dawn Molumphy

Ever Marie James

James Goodrich

Susan Brewster



ADMINISTRATIVE COMMITTEE

Introduction

The Administrative Committee has the responsibility of investigating the following County departments and agencies:

Arrowhead Regional Medical Center
Clerk of the Board of Supervisors
County Executive Office
County Board of Supervisors
Department of Behavioral Health
Human Resources
Information Services Department
Local Agency Formation Commission
Public Health Department
Risk Management Department
Superintendent of Schools
Cities/Municipalities
School Districts and Community College Districts
Special Districts

The following departments and agencies were investigated:

Board of Supervisors	Risk Management Department
Clerk of the Board	Arrowhead Regional Medical Center
County Executive Office	Human Resources
Community College Districts	Information Services Department

A final report was issued on the following:

Board of Supervisors
Risk Management

Committee members attended the Board of Supervisors meetings and reported any items on the agenda of interest to the committees.

BOARD OF SUPERVISORS

Salaries and Benefits

BACKGROUND

On the ballot for San Bernardino County in 2006 Amendment 38, known as Measure “P” established term limits for members of the Board of Supervisors (BOS) and amended existing Charter provisions. This established a formula for determining the salaries of members of the Board of Supervisors (BOS) based on the average of the salaries paid to their counterparts in the Counties of Riverside, Orange, San Diego and Los Angeles. When passed, it gave each board member a raise of \$50,000 a year.

FINDINGS

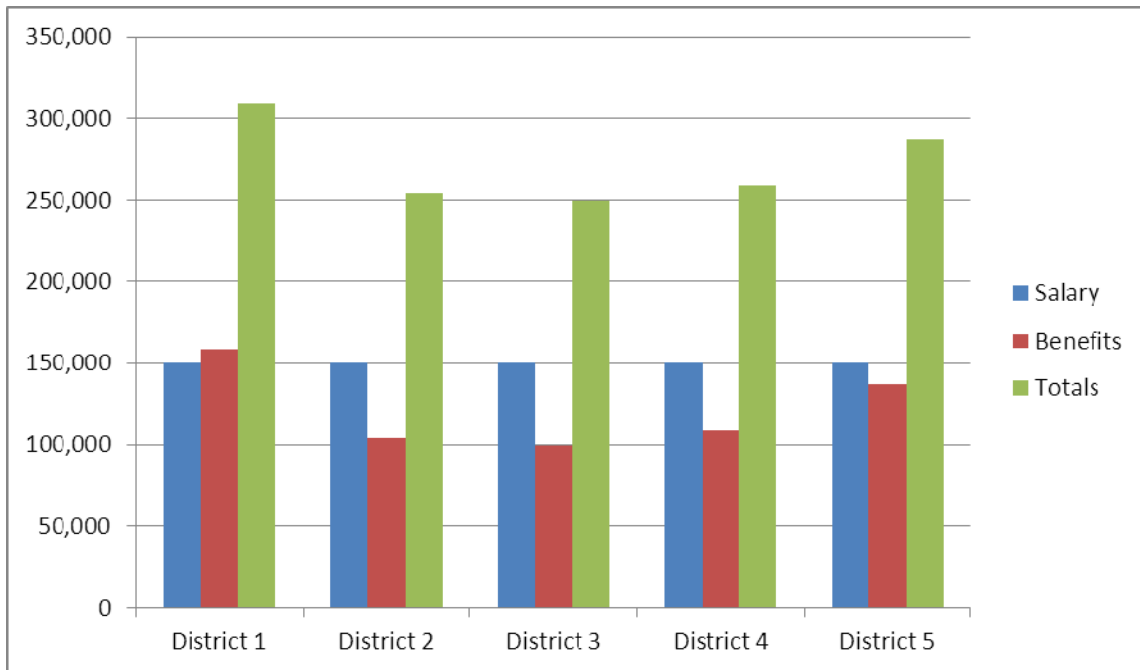
Through our investigation we learned that the board members have very generous benefit packages. This may be due to the comparison between salaries and benefits in the County as a whole. The Chief Executive Officer (CEO) explained that salaries in the County are comparatively low, while benefits are generous. For example, the CEO shared an example of a management position where the salary for our county was around \$148,000 and for the same position in Riverside County it was \$183,000. When you add the benefit package their compensation was almost the same at \$216,000. The County is trying to change this so the salary is higher and the benefits are lower. The Human Resources Director pointed out that the benefits normally should be about half the salary. The BOS benefits are by far much higher than anyone else in the county. One supervisor's benefits exceeded the base salary.

The Grand Jury contacted other counties and requested the salary and benefits for their Board of Supervisors. The following counties were used for comparison: Riverside, Ventura and San Diego. All of these counties base the supervisors pay on a Superior Court Judge's pay. It varied from 80% to 100%. San Bernardino County however based

their salary on the average of four counties: Riverside, Orange, San Diego and Los Angeles.

1. The benefit package should not be more than the salary for the BOS. (See Graph #1)

Graph #1: Annual Salaries and Benefits Charts:



2. Health Insurance Coverage varies for the three supervisors who participate in the program. The three amounts are \$6,569.00, \$19,810.00 and \$30,720.00.
3. The retirement plans paid for all of the BOS are excessive when compared to retirement plans of other counties. One supervisor's retirement benefits exceed \$85,000. Members of the Board of Supervisors are enrolled in more retirement plans than the compared counties. (See Graph #2)
4. The BOS benefit packages range from the highest (First District) \$158,403.00 to the lowest (Third District) \$99,304.00. (See Graph #2)

Graph #2: Detailed Salaries and Benefits

<u>Detail</u>	<u>First District</u>	<u>Second District</u>	<u>Third District</u>	<u>Fourth District</u>	<u>Fifth District</u>
Salary	\$150,197.00	\$150,197.00	\$150,197.00	\$150,197.00	\$150,197.00
401K	\$12,016.00	\$12,016.00	\$12,016.00	\$12,016.00	\$12,016.00
401a	\$16,500.00	\$7,510.00	\$7,510.00	\$7,510.00	\$16,500.00
457b	\$1,502.00	\$1,502.00	\$1,502.00	\$1,502.00	\$1,502.00
Flexible Benefit Plan	\$5,980.00	\$4,200.00	\$5,980.00	\$4,200.00	\$5,980.00
Medical Reimbursement Account	\$1,040.00	\$1,040.00	\$1,040.00	\$520.00	\$1,040.00
Life Insurance County Paid	\$52.00	\$52.00	\$52.00	\$52.00	\$52.00
Variable Universal Life	\$249.00	\$229.00	\$229.00	\$1,579.00	\$1,047.00
Retirement Medical Trust	\$2,628.00	\$4,130.00	\$4,130.00	\$4,130.00	\$1,502.00
Workers Comp	\$1,030.00	\$967.00	\$900.00	\$986.00	\$986.00
Medicare	\$2,669.00	\$2,508.00	\$2,277.00	\$2,517.00	\$2,523.00
Vision	\$147.00	\$147.00	\$147.00	\$147.00	\$147.00
Long Term Disability	\$500.00	\$500.00	\$500.00	\$500.00	\$500.00
Health Insurance Coverage	\$30,720.00	\$0.00	\$6,569.00	\$0.00	\$19,810.00
Retirement Employer Pick Up	\$18,403.00	\$18,090.00	\$14,825.00	\$20,826.00	\$21,897.00
Retirement Employer Pick Up Cash	\$6,168.00	\$5,580.00	\$8,367.00	\$2,879.00	\$1,861.00
Survivor Benefit	\$26.00	\$26.00	\$26.00	\$26.00	\$26.00
Retirement Employee General	\$34,473.00	\$32,096.00	\$30,834.00	\$32,189.00	\$32,329.00
Automobile Allowance	\$21,900.00	\$11,400.00	\$0.00	\$14,600.00	\$14,600.00
Cell Phone Allowance	\$2,400.00	\$2,400.00	\$2,400.00	\$2,400.00	\$2,400.00
TOTAL	\$308,600.00	\$254,590.00	\$249,501.00	\$258,776.00	\$286,915.00

5. When compared to other counties, the car allowance is excessive. All three counties used to make comparisons, San Diego, Ventura and Riverside, showed that car allowances were the same for all supervisors. (See Graph #3)

Graph #3: Annual Car Allowance

District	San Bernardino County	Ventura County	Riverside County	San Diego County
First	\$21,900	\$4,500	\$.51 per mile*	\$8,820
Second	\$11,400			
Third	Car provided			
Fourth	\$14,600			
Fifth	\$14,600			

*At \$.51 per mile, the \$4,500 for Ventura computes to 8,823 miles and San Diego's \$8,820 computes to 17,294 miles

RECOMMENDATIONS

11-01 The Board of Supervisors car allowance follows the Federal guidelines (presently \$.51 per mile). (Finding 2)

11-02 The Chief Executive Officer continue his efforts to adjust the salary and benefit ratio to be competitive. (Findings 2, 3)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
Chief Executive Officer	11-01 through 11-02	September 30, 2011

RISK MANAGEMENT

BACKGROUND

The County of San Bernardino Department of Risk Management is responsible for the identification, assessment and prioritization of risks associated within the operation of county departments. The department's task is to protect San Bernardino County, (people, property, equipment and funds), from the chance of injury, damage or loss. This is achieved by providing management a source of consultation, guidance, training and technical support relative to occupational safety and health, loss prevention, regulatory compliance, and risk/hazard analysis, while improving the conditions in which services are rendered to the public.

FINDINGS

Dashboard is a computer-based liability tracking program, available to all county departments. The program permits the monitoring, identifying and controlling of risk exposures of county departments, such as Worker's Compensation, civil lawsuits and preventable injuries. An example of this is the Arrowhead Achievement Program. In this program county departments are recognized and incentivized for their efforts in identifying risks through an audit process. Methods, goals and definitions vary according to whether the risk management, for example, is in the context of security, actuarial assessments, public health and safety.

It should be noted that in an ideal risk management department, a prioritization process is followed. The risks with the greatest loss and the greatest probability of occurring are handled first and risks with lower loss are handled in descending order. Risk management also identifies areas of risk that have a high probability of occurrence, but these are often ignored due to these risks not being identified or acknowledged. This can occur when insufficient knowledge is applied to a situation, or when bad decisions are made, the result of which causes a new knowledge of risk to materialize.

COMMENDATION

The Grand Jury commends and recognizes the hard work of the Risk Management Department in the continued development, training and use of the “Dashboard” program.

AUDIT/FISCAL COMMITTEE

Margaret Furman, Chair

Alfred J. Dubiel

Arnim Belke

Dawn Molumphy

Allen “Skip” Burt

Susan Brewster

Wayne L. King



AUDIT/FISCAL COMMITTEE

Introduction

The Audit/Fiscal Committee investigates matters pertaining to sound financial practices as they apply to county and other governmental agencies, such as:

- Assessor/Recorder
- Auditor Controller/Treasurer/Tax Collector
- Purchasing Department
- Cities/Municipalities
- School Districts and Community College Districts
- Special Districts

Because of its broad interagency scope, the Audit/Fiscal Committee coordinates its activities with other jury committees. This year, that coordination consisted of disseminating internal audit findings to the committees affected.

The committee conducted investigations regarding the following:

- Assessor
- Auditor
- Controller
- Purchasing
- Recorder
- Tax Collector
- Treasurer

Final Reports written by this committee are:

- Assessor
- Auditor-Controller

ACCOUNTING COMPUTER SYSTEM

BACKGROUND

San Bernardino County is the largest county in the contiguous United States, encompassing 20,000 square miles; and it has a Gross Domestic Product (GDP) greater than several states. In addition, San Bernardino County is the employer of over 18,000 persons, and conducts business in much the same manner as a large corporation, particularly in the area of its Financial Management System. Just like any large employer, it needs to be on the cutting edge of technology to stay competitive.

FINDINGS

1. In the 2003-2004 Grand Jury report, the Audit/Fiscal Committee addressed the issue of the outdated Financial Management System the county was using (AMS Advantage version 2.1.1), and the problems that will occur if the system was not upgraded. The Grand Jury made this recommendation to the Auditor/Controller-Recorder (ACR) who, in response to the recommendation, was in agreement. (See Attachment #1)

In the interviews the Grand jury conducted with the ACR and staff members, there was no opposition to upgrading the system; and in fact, in the years following the report, there were some efforts to upgrade or replace the system. These efforts fell short of the mark due to miscommunications between departments, and budget restraints. The bottom line is, seven years later, the county is **still** using AMS Advantage version 2.1.1 as its Financial Management System.

The Grand Jury is very aware of budgetary problems plaguing the entire nation, from the smallest of villages to the federal level. The county efficiently managing its assets should be very high on its list of priorities.

RECOMMENDATIONS

11-03 Acquire the AMS Advantage Version 4.0 System (or the most current version) to upgrade the Financial Management System; and put a procedure in place that mandates periodic updating. (Finding 1)

11-04 With the acquisition of a new computer system comes the need for additional technical support. Insure employees have the necessary training in order to best operate, and support, the new system. (Finding 1)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
Auditor/Controller- Treasurer/Tax Collector	11-03, 11-04	August 30, 2011

2003-04 GRAND JURY REPORT

RESPONSE FORM

ATTACHMENT #1

GROUP: FISCAL

DATE: July 23, 2004

DEPARTMENT: AUDITOR/CONTROLLER-RECORDER

SUBMITTED BY: LARRY WALKER

PAGE: 1 of 2

AUDITOR/CONTROLLER-RECORDER

FINDINGS – AGREE

RECOMMENDATION: 04-07:

Purchase the AMS Advantage Version 3.0 System to upgrade the Auditor/Controller-Recorder's financial management system and the Purchasing Department's Procurement software system.

RESPONSE:

The ACR agrees that the Auditor/Controller-Recorder's financial management system and the Purchasing Department's Procurement software system should be updated. Upgrading to the current vendor's product, AMS Advantage Version 3.0, is one option but we believe it would be beneficial to consider other possible software solutions as well. Accordingly, the ACR presented an agenda to the Board of Supervisors on May 18, 2004 to approve and authorize release of a Request for Proposal (RFP) for the improvement or replacement of the current Financial Accounting System (FAS). The RFP process allows the County to properly evaluate all qualified vendors and make a decision on the best system currently available. The Board of Supervisors unanimously approved the item and the RFP was released on May 18, 2004. Four proposals were received by the June 22, 2004 deadline.

The RFP selection committee met on June 30, 2004 to rate the proposals. The evaluation committee's recommendation was presented to the FAS Steering Committee for review on July 1, 2004. An agenda item will be prepared for the Board of Supervisors approval of a contract with the successful vendor in August 2004. The new FAS will include many new modules such as for the purchasing functions.

LOCAL COST IMPACT:

The projected contract cost to purchase and implement an upgrade or new financial accounting system is estimated to be \$5,000,000.

ASSESSOR'S OFFICE

BACKGROUND

The Audit/Fiscal departments of the County are audited by several State agencies.

FINDINGS

1. From an internet search, our committee discovered that the California Board of Equalization (BOE) had completed an extensive Assessment Practices Survey of the San Bernardino County Assessor's Office. This document is the current report of their BOE audit. The perspective of the BOE was very helpful in assisting the Grand Jury understand mechanics of the Assessor's function. Instructions on the cover page of the Survey state that the responses to the BOE from the Assessor's Office should be sent to the Grand Jury. The report was not provided to the Grand Jury and we found it during our own independent investigation.

2. The Grand Jury made an appointment with the Assessor to discuss the nine areas the BOE had pointed out for improvement. We also inquired of the Chief Executive Officer (CEO) as to which office in the county kept a log of the state audits. We were informed that no one is assigned that task because the state audits are random and timing cannot be anticipated.

RECOMMENDATIONS

- 11-05 As a courtesy, the BOS provide the Grand Jury copies of all financial audits completed by state agencies including copies of all replies.
(Findings 1, 2)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
Chief Executive Officer	11-05	September 30, 2011

COUNTY INTERNAL AUDITS

BACKGROUND

§925 of the California Penal Code authorizes the grand jury investigation of county officers, departments or functions; operation, accounts and records; investigation and reports.

The Grand Jury examined the Comprehensive Annual Financial Report (CAFR), for Fiscal Years Ending (FYE) June 30, 2009 and June 30, 2010, prepared by the Office of the Auditor/Controller-Recorder/Treasurer/Tax Collector. The CAFR provides detailed financial information regarding the County's financial position and activities prepared in accordance with generally accepted accounting principles of the Governmental Accounting Standards Board (GASB). Staff of the controller's accounting department showed us the Power-Point training program used to train staff in the forms and procedures needed for year round accounting including steps taken for the closing of the "books" (General Ledger) at the end of the fiscal year. Controller's staff provided us a hard-copy of the training manual and CDs on grant audits, airports and fire, and special districts.

During the closing, accrual packages are prepared to identify any inter-fund transactions not recorded during the fiscal year and to match the revenue and expenditures to the proper accounting periods. "Booking" these adjustments into the computerized general ledger results in the final accounting data that is available for the report writing tool that produces the official financial reports e.g. the CAFR. The financial statements are the responsibility of management.

Before the CAFR is released to the public it is necessary to have a Certified Public Accounting (CPA) firm express an opinion on it. The Board of Supervisors (BOS) contracts with an outside independent CPA firm that plans and performs an audit, according to Governmental Auditing Standards. The outside auditors consider if management's control, e.g. internal control, over financial reporting is sufficient for the CPA firm to rely upon that control in planning their audit. The outcome of the audit is to be able to render an opinion on

the financial statements. To do this, the CPA firm needs to obtain reasonable assurance that the financial statements are free of material misstatement.

From the Auditor-Controller's Department we received copies of 2009 management letters from the outside CPA firm. Two examples that demonstrate the CPA/client relationship are:

1. The CPA firm observed that while most departments submit proper documentation supporting their year-end accruals, there were certain accrual packages that did not contain sufficient documents causing both Auditor-Controller/Recorder (ACR) and the outside auditors to perform additional research to obtain proper documentation. The outside auditors recommended the ACR implement stronger internal controls over the year-end accrual packages as insufficient documentation increases the risk of misstatement of the financial statements. The ACR concurred with this recommendation and responded that they will modify the year-end closing process to ensure sufficient appropriate support is present for the accrual packages. *The 2010 management letter reported that improvements have been made.*
2. The CPA firm observed that from their test work of the year-end property tax receivables they noted that the County uses an excel spreadsheet to accumulate, analyze and determine the year-end property tax receivable amounts. Through recalculations performed over certain line items/totals the audit identified certain formulas within the cells on the spreadsheet were not properly linked. They recommended particular attention be placed when this spreadsheet is rolled forward for the next fiscal year to ensure that the cells are properly linked to prevent the risk of misstatement. The ACR concurred with this recommendation and responded that a detailed procedure to initialize this annual worksheet has been developed and the worksheet has been enhanced to contain check figures to ensure accuracy and facilitate management review. *The 2010 management letter reported this problem has been corrected.*

We received an organizational chart with the new staffing assignments (after the reorganization of the County Audit Fiscal segment) that report to the person with the

combined roles of Auditor-Controller/Treasurer/Tax Collector/Director of Central Collections and Clerk.

Members examined quarterly internal audit reports prepared by the County Internal Audits Section (IAS). We received information about the role and responsibility of the Audit Committee, and performance schedules for internal audits including risk assessments.

The committee conducted several individual and group interviews of financial staff members and leaders and had one meeting with the County outside CPA firm. Information was compared to data released to the public on the San Bernardino County website <sbcounty.gov/acr>, other county websites, and our internet research.

Based on our investigation, the Grand Jury concludes that the internal audit function in the County fiduciary sectors is the most important safeguard of public funds; and is the foundation to the entire financial reporting system.

This conclusion is based on The Institute of Internal Auditors (IIA) that developed the globally accepted definition of internal auditing, as follows: “Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. Independence is established by the organizational and reporting structure.”

FINDINGS

1. As a result of The American Recovery and Reinvestment Act passed by Congress on February 13, 2009 state and local governments may be able to qualify for significant financial aid. Control procedures over Federal expenditures are required and they must be properly working to prevent unallowable expenditures. Management would be subjected to significant responsibility upon receipt of these funds. To bring

accounting systems up to these standards, new internal controls may need to be established to meet the stringent reporting requirements of the federal agencies.

An analysis of how Federal expenditures are currently handled by the Controller's Division is explained in Management Letters to the Board of Supervisors dated March 28, 2011, FYE June 30, 2010, and dated March 19, 2010, for FYE June 30, 2009. These describe the observations made by the outside auditors during their audit and their recommendations on ways the Controller's Office could improve compliance in the handling of federal programs. This information, along with the response of management is found on the Auditor Controller-Recorder website.

2. In a December 4, 2009 Management Letter for fiscal year ended June 30, 2009 from the County's outside auditors to the Audit Committee, "It was noted that the county had not recorded a loan receivable that resulted from an agreement approved by the Board of Supervisors in fiscal year 1998 between the County and the City of Adelanto. The principal amount of the loan was approximately \$11 million with accumulated accrued interest of approximately \$6 million" The auditors noted that although the loan was being tracked in the property tax section of the Auditor-Controller/Recorder Office, the loan was never communicated to the general accounting section of the ACR for recording in the County's general ledger.

While the CPA firm states it believes this to be an isolated incident, they recommended all county departments need to be notified that any loans that the County enters into during the fiscal year should be immediately reported to the ACR, along with the supporting documentation to properly book the loan or keep track of the loan at the ACR. Also, at year-end the departments should be proactive on reporting the ending balances as of June 30 of the fiscal year on the accrual packages (if they are keeping track) that are submitted to the ACR.

The response from the County was to concur and staff stated that the "ACR will notify the Clerk of the Board to include ACR-General Accounting on the

distribution list of board agenda items approving loans, advances, investments or repayment schedules crossing years.” *The 2010 management letter reported that no new situations like this had been discovered.*

3. The standards for conducting government internal audits are set by the US Government Accounting Office (GAO) and the Institute of Internal Auditors (IIA). GAO and IIA state that the combination of auditing and controllership responsibilities impair the independence of the audit function and as such disqualify any resulting audit report as not meeting the independence and objectivity standards in fact or appearance. In San Bernardino County, the chief financial officer is the Auditor-Controller. Thus the combination of these two functions does not meet this standard of independence and objectivity. IAS staff agrees that this is a de facto conflict.

Statements from more than one member of the auditing staff, reporting on Treasurer’s Investments as of September 30, 2009 and December 31, 2009, stated that “On February 25, 2010 the Board of Supervisors consolidated the elected offices of the Treasurer-Tax Collector and the Auditor-Controller/Recorder. As a result, the auditor, auditee, and subject matter of this report are within the same department”.

These reports with this wording were distributed to both the Board of Supervisors and the Grand Jury with apparently no alarm expressed of the conflict the BOS created by allowing the consolidation after the prior Treasurer-Tax Collector vacated his elected office and an elected position was eliminated by assigning the tasks of Treasurer/Tax Collector to the elected position of Auditor-Controller/Recorder. The Grand Jury however, finds this situation problematic.

4. According to our investigation the IAS performs financial statement audits to develop staff and increase the reliability of the County’s audited financial statements. In two situations internal audits were performed by employees in the

office of the Auditor/Controller-Recorder who hold Certified Public Accounting (CPA) credentials; these were printed on county letterhead stating that the audit is an “Independent Auditor’s Report.” On the face of it, this is misleading. An employee has duties to his employer and is directed by the employer; but an independent auditor cannot be obligated in any manner to the client or independence is lost. The words “Independent Auditor’s Report” do not per se make the auditor independent. The Grand Jury commends the IAS department for using an employee with expertise as a CPA to develop staff but there is potential here for misunderstanding of independent functions.

5. Our research of the organization of internal audit departments in other California counties shows that in Ventura and Riverside Counties the internal auditor reports to the Auditor-Controller as we do in San Bernardino County. Twenty-four of the fifty-eight California Counties have combined Assessor-Recorder’s, and at least 10 Counties including Sacramento, Fresno and Santa Clara have combined Auditor-Controller/Treasurer/Tax Collector, functions.

It is notable that the Grand Jury found no county where as many important positions are held concurrently by one person as is the case with the San Bernardino County Auditor-Controller/Treasurer/Tax Collector/ and County Clerk. The combining of tasks occurred on the February 25, 2010 consolidation when the offices of Auditor-Controller/Recorder and Treasurer/Tax Collector were made into a single office. While the combination of offices is allowable under Government Code §24300, the Grand Jury finds, in practice, in San Bernardino County the Controller’s Office, not the Auditor’s Office, does the risk assessment that determines which departments are to be audited. This chain of authority may not have been anticipated when the consolidation was deemed to be beneficial to the County.

San Bernardino County is not out of the norm in combining the Controller/Auditor function. However, we are not the first Grand Jury to point out the inherent problems in this and to recommend a separation of the Auditor’s function from the

Controller's function. Orange County (OC) has organized an Internal Audit Department that reports directly to the Board of Supervisors and is connected to the Controller's function. Currently the OC Director of Internal Audit is a CPA and Certified Auditor with numerous professional awards.

The recommendation to have the OC top internal auditor removed from the controller's function came from the 2007-2008 Orange County Grand Jury. That Grand Jury stated that they wanted to ensure the independence of the internal audit function from the direct influence of management. They understood the difficulty of auditing the boss.

To accomplish this goal, the OC Grand Jury asked the Board of Supervisors to exercise their authority in California Government Code §25250 (governing financial powers), and §26881, and §26883 (governing clerks and county controllers) for authority to determine who shall conduct biennials audits of County Officers and who shall perform internal audits. Their research concluded that they could reassign internal audit responsibilities to a separate Internal Audit Department that would conduct financial, compliance, and performance audits of all county departments.

The San Bernardino County Grand Jury finds that the OC method of separation of the Controller's function from the Auditor's function has merit. In OC, the BOS chose to have the head of the Internal Audit Department report directly to them.

6. Staff in the Internal Audits Section (IAS) was reduced. Three years ago, the IAS had twenty positions, with most of them filled. The current lack of funding impacts all aspects of county government in this era of post 2008 financial-melt-down; and hard decisions need to be made. When budget cuts are required, priorities must be set.
7. The IAS is currently operating with eleven full-time positions. The organizational chart specifically identifies a Chief Deputy Auditor with a secretary, a Management Services Manager, two Systems Accountant Level III, four Systems Accountant

Level II, one Accountant Level III, and one Accountant Level II. The positions for another Accountant Level II and a Public Service Employee are vacant due to recent promotions.

The IIA's International Standards for the Professional Practice of Internal Auditing require that the chief audit executive (in San Bernardino this would be the Chief Deputy Auditor) report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. To achieve necessary independence, best practices suggest the chief audit executive should report directly to the Audit Committee or its equivalent. For day to day administrative purposes, the chief audit executive should report to the senior executive of the organization.

8. Although for FYE 2010 the IAS reviewed department accrual packages designated as high risk by the Controller's Division General Accounting Section, some internal audits are not being performed.

The Grand Jury received a letter from the office of the Auditor/Controller/Treasurer (ACT) explaining why there were no audit reports for the quarter ended September 30, 2010. We were reminded that, "As discussed during our recent meeting, this office has the responsibility to pay employees and vendors, produce financial reports, and perform audits. During times of reduced resources, the first three listed activities are deemed a higher priority. Internal audit activity is deferred much as fixed asset maintenance is for other entities in difficult economic environments."

The Grand Jury received a schedule of audits accomplished for FYE June 2008 and 2009. Although the internal audit guidelines say all County Departments and Special Districts are to be audited every year, at the time they provided us with this data the Department stated they can't accomplish that with their seven auditors and four support personnel. They prioritize their tasks based on their evaluation of High, Medium, or Low Risk for the County Departments and fall back on the every-five-year-rule mandated for Special Districts. The risk level is determined by the

Controller Division's General Account Section. The numbers in the financial statements are only as good as the systems that produce them.

9. According to the Auditor-Controller/Recorder/Treasurer/Tax Collector, and County Clerk, in the letter to the Board of Supervisors accompanying the CAFR we learned it is "the responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosure, rests with the County." Also in the CAFR, we know the role of the outside CPA firm does not include examining the effectiveness of internal control and it does not provide assurances on internal control. This demonstrates that the responsibility for the value of the data rests upon the client. In this case the County of San Bernardino.

This conclusion is confirmed in the second page of the letter to the Board of Supervisors in the section under Internal Controls. "The County's internal accounting control system exists to provide reasonable, but not absolute, assurance that assets are safeguarded against loss or unauthorized disposition and to provide reliable records for preparing financial statements and maintaining accountability for assets."

According to the Audit Committee charter: Members of the Audit Committee are:

1. Chair and Standing Member: Auditor/Controller- Tax Collector (ACT)
2. One member of the Board of Supervisors, or other representative appointed by the Chair of the Board of Supervisors. This representative shall serve for a two year period coterminous with the term of the Chair of the Board and appointed by the new Chair on the taking of office.
3. The Chief Financial Officer (CFO), or representative appointed by the CFO, will also be a Standing Member.
4. Two public members; the terms of which shall be for a period of three years, staggered by one year. Both public members must be certified public accountants (CPAs) and have an understanding of generally accepted

governmental accounting principles and financial statements and knowledge of the standards issued by the Institute of Internal Auditors (IIA).

- a. One of which is selected by the Chair of the Board of Supervisors
- b. The other is selected by the Auditor-Controller/Treasurer

10. In San Bernardino County, the role of the Audit Committee is multifaceted. The Audit Committee receives and examines the Single Audit opinion by the outside independent auditing firm including the management letter. Members also review the audit activities of the Auditor-Controller's office and review the accounting process that develops the Comprehensive Annual Financial Report (CAFR). In that role the Audit Committee would be opining about internal controls and the function of internal audits. The Audit Committee also reviews the Fraud Waste and Abuse hotline. Using an Audit Committee that meets at least on a quarterly basis was the recommendation of the outside auditors. This will accomplish good internal control structure and good communication between financial functions within the county.

The concept is favorably received by the Grand Jury. In fact, the implementation of an enhanced Audit Committee could well be considered the acceptable outcome from the 2008-2009 Grand Jury recommendation which called for better oversight of internal audits.

The spread of expertise on the Audit Committee includes two department heads or their appointees. One of the department heads (the ACT) is elected. There is another elected official, or his/her appointee, and two financial professionals well versed in accounting. No one sitting on the Audit Committee presently fills the role of a citizens' watchdog.

RECOMMENDATIONS

11-06 The Board of Supervisors (BOS) increase the authority and scope of the Audit Committee by empowering it to see that the procedures for accounting

for funds in federally funded grants is implemented according to the concurrence, agreements, and promises of the Controller's Office. (Finding 1)

- 11-07 The Board of Supervisors authorize the Audit Committee to look into the internal controls procedures of all County departments, and other entities for which the BOS sits as the governing body such as the Redevelopment Agency, to determine if upgraded internal controls would benefit these accounting centers. Consideration should be given to implementing uniform standards in all agencies and departments irrespective of whether they are subject to mandated or non-mandated audits. (Finding 2)
- 11-08 That the BOS authorize the Audit Committee to monitor the property tax allocation schedules of the Property Tax Division in the Treasurer-Tax Collectors Office as this relates to property tax increment payments to or from cities, special districts or redevelopment agencies; and that this monitoring of payments to/from cities or agencies is done each year irrespective of when the State of California conducts its audits. (Finding 2)
- 11-09 The Board of Supervisors consult with appropriate State Agencies to determine if the combination of the functions of Treasurer-Tax Collector and the Auditor-Controller is compatible with standards of good governance and fiduciary responsibility. A ruling from the State Attorney General be requested to determine if the County violated voter rights when it eliminated the elected office of Treasurer-Tax Collector when it became vacant and subsequently combined the duties of that office with another elected office which appears to create a conflict of interest. (Finding 3)
- 11-10 The use of the term "Independent Auditor" be reserved for only those audits done by outside firms or agencies and not be used by employees of the county when auditing elements of the County financial systems. (Finding 4)

- 11-11 The San Bernardino County Board of Supervisors enhance and improve the quality, efficiency, and performance of the internal audit function by using their authority to hire a Chief Audit Executive as a Civil Service employee. The independence of the internal audit function will enhance the accountability of the Chief Audit Executive in performing his/her internal financial, compliance, and performance audits. This Chief Audit Executive is to report directly to the San Bernardino County Chief Executive Officer (CEO) for administrative matters and to seek guidance on the scope and performance of the audit function from the Audit Committee. This chain of responsibility is different from the OC model but as we point out elsewhere in this report, in San Bernardino County there already is in place an Audit Committee that reports to the Board of Supervisors. (Finding 5)
- 11-12 Audit all County Departments and Special Districts every year. (Finding 6)
- 11-13 The Chief Deputy Auditor report to the County CEO for administrative issues. (Finding 7)
- 11-14 The Chief Deputy Auditor report to the Audit Committee to inform them of the issues coming up on the audit and look to them for direction and accountability. (Finding 8)
- 11-15 The County Board of Supervisors extend an invitation to each year's sitting Grand Jury to attend the quarterly meetings of the Audit Committee. (Finding 10)

Responding Agency	Recommendations	Date Due
Board of Supervisors	11-06 through 11-09 11-11, 11-14, 11-15	August 30, 2011
Auditor/Controller-Treasurer	11-10, 11-12	August 30, 2011
Chief Executive Officer	11-13	September 30, 2011

COMPLAINTS

Robert R. Dunlap, Chair

Becky Fults

Bob Mitchell

James Goodrich

JoAnn L. Miller

Margaret Furman

Melinda O'Connor

Wayne L. King



COMPLAINTS COMMITTEE

The Grand Jury receives complaints throughout the year coming from the residents of San Bernardino County. They are also accepted from various agencies and other entities.

The purpose of this committee is to review all complaints and determine if the Grand Jury has jurisdiction to investigate the complaint. If jurisdiction is confirmed, and the complaint warrants investigation, it is assigned to an appropriate committee. In some cases, an ad hoc committee is formed to handle the complaint. Complaints are typically received on an official Complaint Form. Although the Grand Jury normally does not investigate unsigned complaints, sometimes, depending on the issue, it will conduct an investigation from an anonymous source.

The 2010-2011 Grand Jury received 48 new complaints, with 12 complaints referred from the 2009-2010 Grand Jury, for a total of 60 complaints. Of those, 15 were assigned and investigated; four of which were directly or indirectly responsible for final reports. Forty-three complaints were not within the jurisdiction of the Grand Jury. The remaining two complaints are being referred to the 2011-2012 Grand Jury.

ECONOMIC DEVELOPMENT COMMITTEE

James Goodrich, Chair

Alfred J. Dubiel

Becky Fults

Ever Marie James

Melinda O'Connor

Miguel A. Ibarra

Wayne L. King



ECONOMIC DEVELOPMENT COMMITTEE

Introduction

The Economic Development Committee had the responsibility of reviewing economic development operations in the following county departments, cities and/or agencies:

- Economic Development Agency
- Housing and Community Development
- Redevelopment Agency
- Workforce Development Agency
- Cities/Municipalities
- School Districts and Community College districts
- Special Districts

Agencies, Cities, and/or Departments that were reviewed are:

- Big Bear Lake City
- City of Rialto – Building Code Enforcement
- Community of Baker
- Lucerne Valley School District
- San Bernardino City Economic Development Department
- San Bernardino County Economic Development Agency
- Special Water Districts

The Economic Development Committee submitted reports on the following:

- City of Rialto – Building Code Enforcement
- Community of Baker
- Lucerne Valley School District

CITY OF RIALTO

Building Code Enforcement

BACKGROUND

A complaint was received by the Grand Jury from the owner of what was described as a custom built single-family house in the City of Rialto. The complainant discovered numerous defects with the completed house, including plumbing and major framing/structural problems. These complaints were reported to the city's building department and city officials without any meaningful action being taken.

The complainant employed experts in the construction field to inspect the home and submit written reports on defects. These reports were reviewed by members of the Grand Jury.

Members of the Grand Jury met with the Senior Planner of the City of Rialto to inquire about the process of constructing a new house within the city. We were furnished copies of a fee schedule and forms required to be filed before a building permit is issued.

An interview was conducted with the Code Enforcement Supervisor of the Building Development Department, City of Rialto, to ascertain how state and local construction code standards for housing are enforced. The interview revealed that an on-site city inspector signs off each phase of construction, from lot grading to exterior/interior finishing as they occur, until the house is completed. Sign off by the inspectors is entered on the back of the building permit posted on each house under construction.

The statements made on the Grand Jury complaint form were confirmed verbally, in an in-person interview with the complainant.

Members of the Grand Jury visited the City of Rialto's Building Department to secure information on complaints about new home construction filed with the city between January 2008 and December 2010. The visit was coordinated through the City Clerk's Office and a Records Coordinator who accompanied the grand jurors during the visit. Rialto's Building Department records are on paper, and filed by street address. Locating a past complaint proved difficult because of the address-key filing system. Current building code complaints are kept separately until investigated and resolved, then put into the large general file.

An additional interview was conducted with the Supervisor of the Code Enforcement Division to gain additional information regarding the practices, policies, and procedures involving residential building construction. This interview was followed in a telephone interview with the Supervisor to clarify further information about personnel in the building department and code enforcement during 2008 and 2009.

The California State Contractor Licensing Board was contacted by phone regarding the number of complaints they had received about specific builders in the City of Rialto between 2008 -2010. The result was a telephonic response indicating that only one complaint had been recorded.

All building projects start with a map required by the California Subdivision Map Act:

- 4 homes or less - a parcel map is required
- 5 homes or more - a tentative tract map is required and must include streets, sidewalks, lighting, sewers and any other improvements required by the city (this map is assigned a number and is good for two years, with extensions available)

The appropriate map is sent to both the planning division and engineering division for review to ensure the plan meets zoning requirements, structural density and the site improvement requirements of the city. After meeting the plan checker's satisfaction, the proposed project is presented to the planning commission, then to city council for

approval. After approval of the plan or tentative track map, it is recorded in the County Map Book.

The builder takes the approved site plans to the city building department, where they are checked for structural soundness, soil compression, electrical, and foundation details prior to a building permit being issued. Inspectors in the city building/planning division visit the construction site and monitor the work periodically. Inspections are required at set stages of construction. Work must stop until the building inspector has signed off that the standard is met per tract phase, i.e. foundation, underground fixtures, etc. Once a builder has completed a house, he files for a Certificate of Occupancy from the building department. The entire tract does not need to be finished at the same time. There is no single document titled "Certificate of Occupancy" utilized, but the final inspection is recorded on the back of the building permit which serves as the same thing.

Building inspectors earn their certification through testing with the International Code Council (ICC). The city claims their responsibility is to ensure that construction was done properly, built to plans and code. The City of Rialto verifies the building is done according to plans. The building department currently employs two inspectors and one supervisor. The engineering department has one engineer and one supervisor. All are required to be state licensed. During the building boom in mid-2000, the city claims they don't know how many inspectors they hired.

During the construction phase, if a structural complaint is received, the builder would be given a correction notice, (two part form.) If after the construction phase, the building Supervisor would check the complaint and issue a correction notice, if appropriate. In either case corrections are required to be completed within a thirty-day time period. The city tracks individual family home construction or modifications through street addresses on a building permit. No procedure is in place to access these records without a tedious hand search by address.

Between January 2008 and December 2010, the building department had no system for the tracking of permitted residential structure construction complaints. If the complaint is received after the house is built, the city claims it is difficult to determine which tradesman was in violation. The actions they could take would depend on the type of violation. When a correction notice is issued it is sent to the appropriate building department for compliance.

During the building boom, the city of Rialto hired contract inspectors and relied on the services of an outside source to verify the contracted inspector's license and certification. In fall of 2009, the Supervisor of the Building Code Enforcement Department retired. At the time of his retirement, there were 300 outstanding building complaints. As of February 2011, half had been resolved.

FINDINGS

1. The City of Rialto follows the State of California Guidelines involved in approving building plans.
2. The City of Rialto has an inadequate record keeping system that requires numerous man-hours to search for new home construction and building complaint information.
3. The process of issuing Correction Notices is not monitored.

RECOMMENDATIONS

- | | |
|-------|--|
| 11-16 | Establish a well-defined building inspection process that ensures State Building Codes are being followed. (Finding 1) |
|-------|--|

- 11-17 Establish a computer based program to track, monitor new home construction and building complaints to replace the current paper-based program. (Findings 1, 3)
- 11-18 Develop a better sign-off process that requires both printed name, signature and license or employee identification number on the building inspection reports. (Finding 2)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
Rialto City Manager	11-16 through 11-18	September 30, 2011

THE COMMUNITY OF BAKER

Community Service District

BACKGROUND

The Baker Community Service District consists of a 4.5 square mile area on I-15 about 60 miles northeast of Barstow, California. The district serves about 600 residents; most are employed in this desert community. Baker is known as the “Gateway to Death Valley” along with “The Tallest Thermometer in the World”. The community offers relief to thousands of travelers on their way east or mainly to Las Vegas and serves as a refreshing station for fuel and food. The area is rural desert with mainly mobile style housing and unpaved roads with upgraded facilities for travelers. Eighteen thousand vehicles pass by or through this desert relief station each month.

In March 2011, members of the 2010-2011 Grand Jury attended the publicly scheduled County Service District meeting for Baker. The Grand Jurors also held a “Closed Door” meeting with the district’s General Manager and Secretary after the public meeting. The members had an opportunity to speak at this public meeting and they verbalized the duties of the Grand Jury and how they came to attend their meeting and of our interest in their operations. Each member of the current board expressed their views on the area, intentions, and everyday problems. They expressed a deep concern of the lack of understanding in their plight in Baker’s relationship with the County’s entities, such as Planning, Land Use Services, Building, Transportation and any agency that controls building and roads. Their concerns are focused on the regulatory agencies control of all building and construction in their area, and their applying urban (City) regulations to rural (Desert) communities.

Each member of the board told of incidents when they personally were confronted by a member of the community. Each of the incidents indicated a demanding or unpleasant attitude by county officials, employees, and was given misstated information from the

County. One incident resulted in a cost of over \$50,000.00 of improvements required by the county, only to be told by the county that those improvements were not needed, but others were needed. There were numerous events requiring extensive time consumption or unwarranted expenditures with little economic return for the area. A number of wanted and needed franchises have considered investing in the area only to be frustrated by the county employees and stringent regulations that would make their investment unrecoverable in an appreciable time. The comments from these potential investors indicate they would not invest in a situation that is not properly built or that is economically and ascetically not fit for the budget and the local ambience for a desert community.

FINDINGS

1. There is a single list of regulations that cover urban and rural areas imposed by county departments.
2. The County was working on a “Customer First” approach in the past with potential customers in all areas of contact with counties residences. A sometimes rude and uncaring attitude by the county employees of regulations are interpreted with great unsureity.
3. Most of the communication problems are with Land Use Services, Planning, and Local Agency Formation Commission (LAFCO). This is not only a county problem, but the Baker community has not responded to many of the County’s departments that could supply needed information.
4. The Baker Community Service District has implemented its own improvements without County approval, mainly in the road paving area.
5. The opinion shared by the majority of members of the Baker Community Service District Board is that they are happy with the way things are presently.

RECOMMENDATIONS

- 11-19 Implement a two tiered set of regulations for urban and rural areas. For example not imposing curbs and gutters in extreme rural areas that have no sewers, no containment, and water control programs. (Finding 1)
- 11-20 Treat local residents who request services from our County with courtesy and respect to encourage dialogue. (Finding 2)
- 11-21 More “Face to Face” meetings between the First District County Supervisor, staff members, and Special District members. (Finding 3)
- 11-22 Ensure prompt responses to communications. (Findings 2, 3)
- 11-23 The Community of Baker consider forming their own city, when appropriate. (Finding 5)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
General Manager, Community of Baker	11-20 through 11-23	September 30, 2011
Board of Supervisors	11-19 through 11-22	August 30, 2011

LUCERNE VALLEY UNIFIED SCHOOL DISTRICT

BACKGROUND

School districts in California are required to interact with and obtain approvals from state agencies, including the Office of Public School Construction (OPSC) in order to obtain funding for new school construction and modernization projects. Under the School Facility Program (SFP), the school district must meet a number of eligibility requirements and also demonstrate an ability to meet a state/local match for grant or cost funding. School districts unable to meet some or all of the local matching funds may apply to the OPSC for financial hardship status. If the OPSC approves the financial hardship status, the districts can receive up to 100% state funding for new school construction or modernization projects. To qualify for financial hardship funding, a school district must demonstrate: (1) it is levying developer fees up to the maximum amount allowed by law; (2) it has made every reasonable effort to raise local revenue to fund the project; and (3) evidence of financial inability to contribute the required local matching fund.

As previously noted, the law requires that school districts seeking financial hardship status must demonstrate that all reasonable efforts have been made to raise local revenue for the SFP match requirement. State Allocation Board (SAB) has adopted regulations that set criteria to determine that this requirement has been met. A regulatory criterion is that current outstanding indebtedness of the school district, at time of the financial hardship request, is at least 60% of the district's total bonding capacity. Outstanding indebtedness includes General Obligation Bonds, Mello-Roos Bonds, School Facility Improvement District Bonds, and Certificate of Participation (COP) that was issued for capital outlay school facility purposes, on which the school district is paying a debt service.

The 2010-2011 Grand Jury received a citizen complaint concerning the issuance of COP in the amount of \$7,500,000 by the local school board. The resident was concerned not only with the amount and use of the COP, but the school board's reasoning behind the issuance of the COP. The complaint documentation provided a statement included in the June 7, 2007 minutes of the Lucerne Valley Unified School District board meeting (See Attachment #1). The stated primary reason for the issuance of the COP was to put the school district in enough debt so that the district could declare a state of "hardship" thus allowing the building of two new schools to be paid for by state funds without local matching funds. This was the beginning of an amassing of borrowed monies in the range of \$9,000,000, which would allow the school district to qualify for financial hardship funding. The borrowed monies were utilized for appropriate projects such as purchasing new school buses, paving school approach roads, installing window shades, and a number of other projects.

The Grand Jury met with elected and nonelected school district officials to discuss the loan, the use of the money, and the projects that were completed. The members received details of the school district's financial condition, level of indebtedness, and were assured that the school district was committed to keeping loan payments current and upholding the terms of the loan. The members reviewed a copy of an external audit from H & H auditing firm which stated that audit findings that the School District has used the loan monies in the manner for which they were borrowed, and payments are current as of March 2011.

The members were informed that the method of going into debt to obtain "hardship" status is not unique to the Lucerne Valley Schools District and that schools districts have tried this process of borrowing heavily to accomplish this status.

FINDINGS

1. The regulatory criterion that current outstanding indebtedness of the school district, at the time of the financial hardship request, is at least 60% of the

district's total bonding capacity. This is one of many factors used by the OPSC to determine if a school district qualifies for hardship status. The school board decision in 2007 to issue COP created outstanding indebtedness with no guarantees that OPSC would approve the hardship status.

2. The OPSC has not approved the school application for hardship status as of the date of this report.
3. Although the OPSC regulations do not appear to prohibit school districts from the practice of intentionally increasing outstanding indebtedness to qualify for hardship status, the practice appears to run counter to the goal of the SFP to require school districts to raise funds for the local SFP match.

RECOMMENDATION

- 11-24 Implement policy changes that restrict the creation of outstanding indebtedness for purposes of qualifying for SFP hardship status. (Findings 1, 2, 3)

<u>Responding Agency</u>	<u>Recommendation</u>	<u>Date Due</u>
Lucerne Valley Unified School District Board	11-24	September 30, 2011

Lucerne Valley USD

Agenda Online

Meeting: Emergency Meeting of the Board of
Trustees : C. Action Items

1. Approval of Project Finalization/Funding Plan - The Board of Trustees is requested to approve the district borrowing up to 10 million dollars to fund a variety of projects. (v)

June 07, 2007

Motion Made By : Julia Bell.
Motion Seconded By : Jean Morgan.

Requested Action

The Board of Trustees is requested to approve the district borrowing up to 10 million dollars to fund a variety of projects.

Rationale

This emergency Board meeting is needed to finalize plans for several projects along with a funding strategy to pay for them. The projects include but are not limited to the following: Early Childhood Learning Center, relocating our Pupil Services Division to a new site that will include two new modulars, a new District Office, 8 new air conditioned buses, two new maintenance buildings, improvements to our FFA program, 3 new modulars for the high school, middle/high school landscaping, computers, and a new transportation building on a new site.

The debt that the district will incur will put the district into "State Hardship" status, which means 100% funding from the state, allowing us to have a new elementary and middle school at no cost to the community. The percentage of debt that it takes to reach such status is based on the community's assessed valuation. Many local citizens feel that Lucerne Valley's assessed valuation could rise drastically in the next few years requiring more debt to reach "Hardship Status". The current amount of debt to attain "Hardship Status" is approximately 8.5 to 9.0 million dollars.

The loan the Board is finalizing at its June 20th meeting is called a Certificate of Participation, which is a low interest loan that is available only to public entities. The loan payment schedule will be deferred for three years with the first payment due at the end of year four. The district's plan is to have the annual revenue from the two recently approved charter schools pay back the loan. A worst case scenario would be that the district would have to go to the community for a general obligation bond in three years to repay the 9 million dollar debt if the revenue from both charters is less than anticipated.

The most exciting part for Lucerne Valley is the community will be getting two new schools without raising taxes.

Minutes

The Board of Trustees approved the district borrowing up to 10 million dollars to fund a variety of projects.

Votes

Motion Made By : Julia Bell.
Motion Seconded By : Jean Morgan.
Teresa Reyes - Yes
Jean Morgan - Yes
Tom Courtney - Yes
Bryn Risler - Yes
Julia Bell - Yes

HUMAN SERVICES COMMITTEE

Bob Mitchell, Chair

Becky Fults

James Goodrich

JoAnn L. Miller

Miguel A. Ibarra

Allen “Skip” Burt

Susan Brewster



HUMAN SERVICES COMMITTEE

Introduction

The Human Services Committee reviews social services operations in the county, including:

- Child Support Services
- Department of Aging and Adult Services
- Human Services Group Administration
- Performance, Education & Resource Centers (PERC)
- Preschool Services
- Public Guardian/Public Administrator
- Transitional Assistance Department
- Veterans Affairs Department
- Cities/Municipalities
- School Districts and Community College Districts
- Special Districts

The following departments were investigated:

- Children and Family Services
- Department of Homeless Services
- Preschool Services
- Veterans Affairs
- Welfare Fraud Unit

The Human Services Committee investigated two complaints filed with the Grand Jury, with no findings.

The following is the committee's report, including findings and recommendations, on the Children's Assessment Center.

CHILDREN'S ASSESSMENT CENTER

BACKGROUND

Prior to the opening of the Children's Assessment Center (CAC), abused children referred to Child Protective Services (CPS) often had to endure a number of interviews performed by the multiple agencies involved in the investigation of the case. Often victimized children suffered unnecessary trauma in this process. In 1992, the Children's Network Policy Council established a task force consisting of representatives from Children and Family Services (CFS), County Medical Center, Public Health, Behavioral Health, the District Attorney's Office, the Sheriff's Office, Juvenile Court, Family Law Court, County Counsel, Children's Network, Children's Fund, and Loma Linda University Medical Center (LLUMC) to explore the possibility of creating a quality, comprehensive program, to provide forensic interviews and evidentiary medical examinations in one, child friendly, location for sexually abused children in San Bernardino County.

A partnership between Loma Linda University Medical Center, San Bernardino County, and law enforcement agencies was formed. With the full support of the San Bernardino County Board of Supervisors, the Children's Assessment Center, a private/public partnership, was opened on January 24, 1994, in a suite of offices donated by LLUMC. An Advisory Board was established as the Governing Board for the Assessment Center made up of representatives from all partnership agencies. As the benefits of the Children's Assessment Center services to sexually abused children were realized, it became apparent that these same services would also be beneficial to victims of physical abuse as well as sexual abuse. The Center began to see physically abused children in 1998. The number of Children receiving services increased steadily over these first few years of operation.

In 1999, a larger, more permanent facility was needed for the Assessment Center. Children's Fund, a non-profit organization whose purpose is to raise funds for children in need, entered into a new partnership with San Bernardino County to make that facility a reality. Children's Fund began a capitol campaign to raise the funding for the purchase

and remodeling of the new facility, which is owned and maintained by San Bernardino County. A contract was formed between the administrators of Loma Linda University Children's Hospital, and Children and Family Services under San Bernardino County's Human Services Department. CFS provided forensic interviewers, the Center's management staff, and financial assistance. Currently 80-100 children are seen monthly. Since opening in 1994 over 8,000 children have received services at the Assessment Center.

FINDINGS

1. During the investigation into the CAC partnership, members of the Grand Jury heard many times the Children's Assessment Center is a gift to our county and our children. Nationally there are approximately 180 Board Certified Pediatric Forensic Physicians and San Bernardino County is fortunate to have two such physicians currently and one additional physician soon to be certified. They work tirelessly, and fiercely, for the rights and safety of abused children. Clients of the Center are child victims of alleged abuse from birth to age 18 referred to the Assessment Center by Children and Family Services, a law enforcement agency, and/or the Family Law Court.
2. The Children's Assessment Center is an important tool for the protection of suspected child victims of abuse from duplicative interviews for legal, medical, child protection, and clinical purposes. This streamlining of the process is shown in Attachments #1 and #2, which dramatically shows through the eyes of a child how the Assessment Center approach is less intrusive. The role of LLUMC and the forensic physicians is to medically evaluate the abuse. The role of CFS is to safeguard the children in an immediate crisis (e.g. removal from home, take to the CAC or the emergency room) and to provide recommendations for future steps to correct problems (e.g. parenting classes, nutritional classes, anger, and addiction management). It is the role of law enforcement to identify and deal with the perpetrator of the abuse.

3. The CAC offers an opportunity for all parties to work together while gathering information, and provide a unified response to the family. Services at the Center include forensic interviews by CFS workers who have received specialized training in child forensic interviewing. Evidentiary medical exams are performed at a minimal cost by the three forensic pediatric specialists from the LLUMC. These forensic physicians also provide expert testimony in court. Written reports are provided regarding the outcomes of the interviews and medical appointments. Crisis intervention and referrals for counseling are provided to family members by a Victim Witness Advocate from the District Attorney office assigned to the Center. The Multidisciplinary Team (MDT) meetings discuss cases and the Child Death Review Team meets to discuss the cause of a death.
4. The relationship among the partners began to deteriorate in 2007. It became clear to the Grand Jury through statements we heard from enough sources there was dissension among CFS, the Center, and the partnership arrangement. With budgetary concerns in mind, CFS learned that it was not statutorily mandated to fund the CAC, and not mandated to request a forensic medical examination for a child believed to have been sexually or physically abused. Only law enforcement is required to seek a forensic medical examination of a sexual assault victim. The cost of such an examination is billed to the requesting law enforcement agency. After learning this information CFS discontinued the CAC Advisory Board, and no longer attended the MDT meetings. The partnership started to fall apart.
5. The Grand Jury interviewed many individuals affiliated with the CAC. The following allegations were repeated by numerous witnesses:
 - There seems to be a progressive change for the worse in the attitude of Children and Family Services towards the Children's Assessment Center. There is a lack of communication and cooperation. CFS went from being a partner to being an overseer trying to control all the functions at the Center.

- The Social Workers who bring cases to the CAC are re-active instead of pro-active. They have a fundamental misunderstanding of the cases. They have protocol but don't follow it. There is confusion as to how to work a case. Morale is low.
 - CFS hides behind a screen of confidentiality, and does not want to give out any information. Pertinent information was needed by the Child Death Review Team (CDRT) to determine the cause of death of a child. The team was asked to get a subpoena for the information. CFS refused to let the Grand Jury review even redacted data. We requested statistics and were given a bunch of meaningless numbers. The information that corresponded with the numbers was confidential and not provided. Members of the Grand Jury were invited to attend a meeting of the Child Death Review Team. There they signed a confidentiality statement. Before the next meeting of the CDRT the Grand Jury was "uninvited" by some members because of confidentiality reasons.
 - The mission at CFS is blurred. They appear to have placed a higher priority on budget and lawsuits. Children and Family Services wrote a Request for Proposal (RFP) wanting to sever the partnership with Loma Linda stating it was too expensive. They asked for bids from other medical facilities; one of which was Arrowhead Regional Medical Center (ARMC). A physician from ARMC was brought to tour the Children's Assessment Center facility in order to possibly assume the medical services. However, Loma Linda University Medical Center is the only Children's Hospital with forensic pediatricians in the Inland Empire. ARMC could not find anyone who was qualified. No other facility had personnel with the expertise or could compete financially with the minimal cost of bringing a child to the Assessment center.
6. There is little accountability for Children and Family Services to an outside authority. There is no transparency. Riverside County CFS had an outside audit

conducted by the Child Welfare League of America (see Attachment #3). They now use a system called Technical Assistance, Review and Consultation (TRAC) which has been very successful. Training for this system was offered to San Bernardino County CFS by the Riverside County CFS. The offer was turned down. When the Director of Children and Family Services was asked about TRAC, she stated she had never heard of it. She also stated she is not high on any risk assessment tool. On occasion the state will take “a sampling” of cases to look for compliance.

7. In order to maintain the Center, and the partnership, a new protocol was written by Dr. Clare Sheridan, one of the Forensic Pediatricians from Loma Linda. She suggested two new committees; a Governing Board to meet regularly to decide policy and procedure for the Assessment Center, and an Executive Committee for the month to month management of the Center with Dr. Sheridan as the Chair. The Sheriff’s Department has assumed the financial contract responsibility for the medical examinations related to law enforcement cases but it has not been formalized yet.

The Grand Jury commends CEO, Greg Devereaux for becoming personally involved with supporting the work of the Children’s Assessment Center.

RECOMMENDATIONS

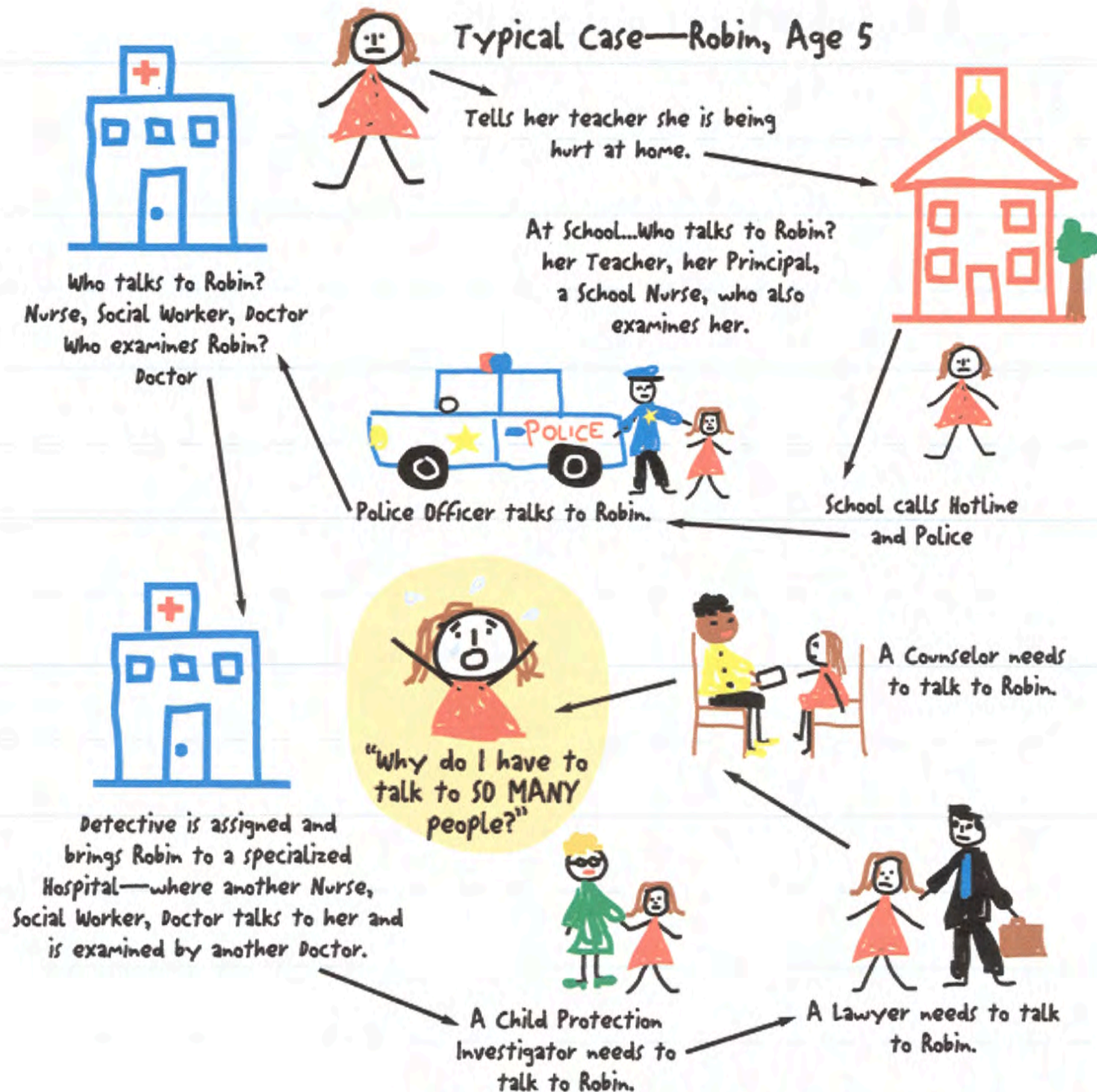
- | | |
|-------|---|
| 11-25 | The Governing Board of the Children’s Assessment Center take a pro-active role in resolving conflicts among the partner agencies so that they work together toward the well- being of the children. (Findings 4, 5) |
| 11-26 | The Governing Board of the Children’s Assessment Center determine appropriate standards and policies to address differences in the role of each agency. (Finding 2) |
| 11-27 | The Executive Committee provide a good medium for discussion so that each agency is in agreement of the best course of action for the children. (Findings 2, 3) |

11-28 Retain a firm with the qualifications and expertise such as the Child Welfare League of America to perform an audit of Children and Family Services to ensure that mechanisms are in place for oversight of the division. (Finding 6)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
Chief Executive Officer	11-25 through 11-28	September 30, 2011

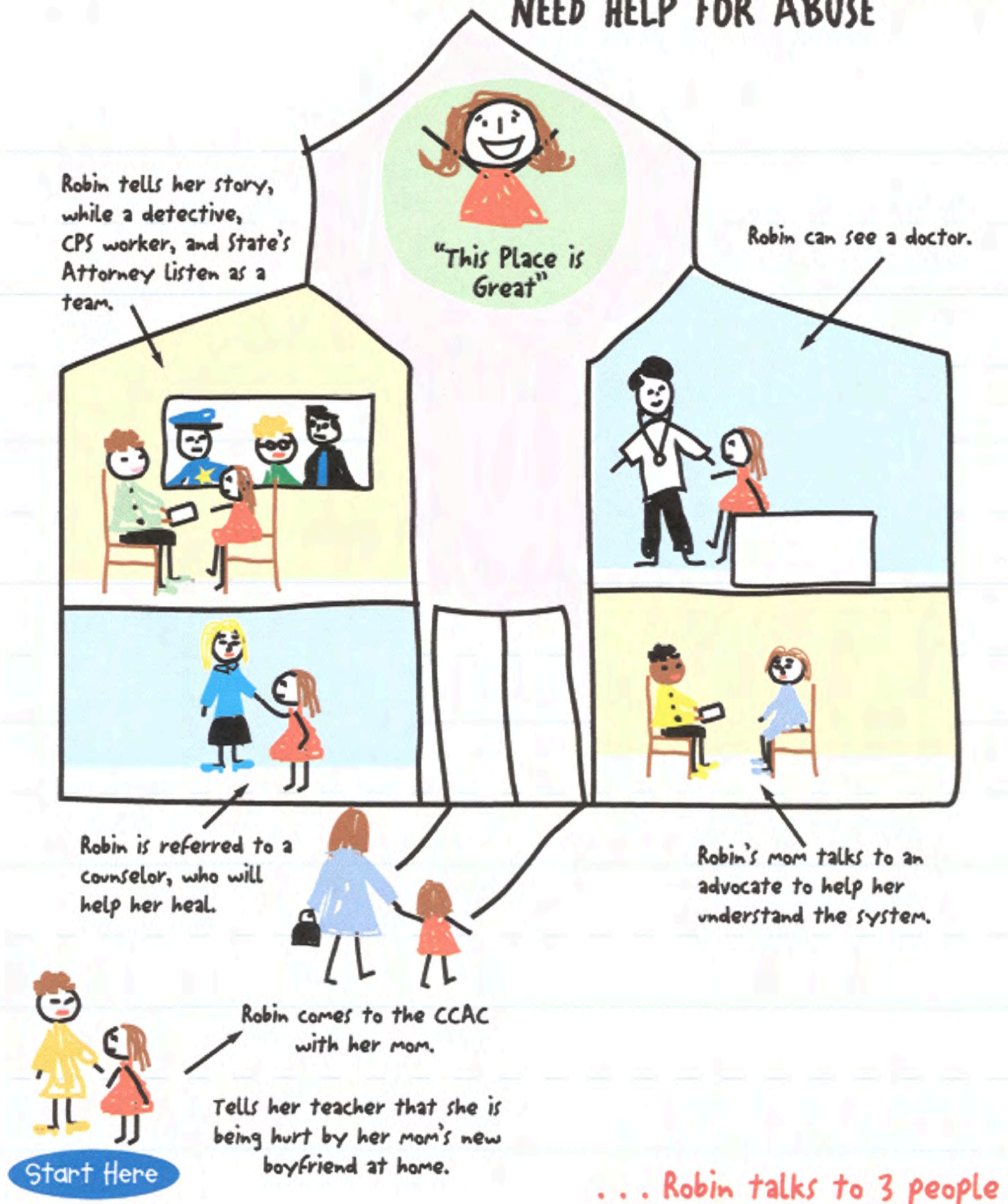
WHAT USED TO HAPPEN WHEN KIDS NEEDED HELP FOR ABUSE

Typical Case—Robin, Age 5



Robin had to talk to 15 people, but now . . .
(turn over)

WHAT HAPPENS TODAY WHEN KIDS NEED HELP FOR ABUSE





ATTACHMENT #3

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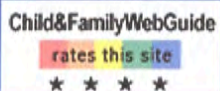
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LAW AND JUSTICE COMMITTEE

JoAnn L. Miller, Chair

Bob Mitchell

Melinda O'Connor

Miguel A. Ibarra

Allen “Skip” Burt

Sylvia Olson



LAW AND JUSTICE COMMITTEE

Introduction

The Law and Justice Committee considers all matters concerning civil and criminal justice, law enforcement and penal institutions:

- County Counsel
- Detention Facilities
- Disaster Preparedness
- District Attorney
- Office of Emergency Services
- Police Departments
- Probation
- Public Defender
- Sheriff-Coroner
- Cities/Municipalities
- School Districts and Community College Districts
- Special Districts

The Committee inspected the following facilities (see attached report):

- Central Detention Center
- Glen Helen Rehabilitation Center
- West Valley Detention Center
- Juvenile Detention Centers located in San Bernardino

Investigations were completed on the following:

- County Coroner/Public Guardian
- District Attorney – Gang Task Force and Hate Crimes Units
- Public Defender’s Office – Indigent Defense
- Sheriff’s Department Crime Lab
- Sheriff’s Internet Fraud Unit
- Sheriff’s Department ICE (Immigration and Customs Enforcement Unit)
- Colton City Police Department – Risk Management
- San Bernardino Police Department – Risk Management
- Contracting Jails – Adelanto and Fontana

An investigation of Indigent Defense Fees resulted in the following report.

DETENTION CENTERS

San Bernardino County Sheriff's Department

CENTRAL DETENTION CENTER

Central Detention Center is located at 630 E. Rialto Avenue, San Bernardino. It averages between 70 and 80 bookings daily, has a capacity of about 1,100, and houses both female and male inmates. There are approximately 500 federal inmates currently housed there, and the county receives approximately \$80.00 per resident, per day from the federal government.

This older facility is linear style, which is more labor intensive because it is difficult to monitor inmates. Guards have to move from one location to another to open cells and climb stairs to the upper tiers. There are cameras mounted all over, except where privacy is required. They have medical staff on duty. All meals are prepared on site.

GLEN HELEN REHABILITATION CENTER

Glen Helen Rehabilitation Center is located at 18000 W. Institution Road, San Bernardino.

The facility was built in 1962 and houses inmates that have been sentenced, and usually stay less than one year.

The goal of this detention center is to return inmates to a productive life. They offer inmates classes in baking, landscaping and printing. The auto shop is currently closed, but it is anticipated it will open again at a later date. All the bakery items for the county detention centers are provided by Glen Helen. All inmates attend classes for continuing education and certificates are issued upon completion of class.

At the time of our visit, there were approximately 250 women and about 350 men. There were also 300 Federal prisoners who are housed in a different area. The capacity at Glen Helen is 1,450. There are 16 deputy sheriffs on duty at any one time, with a crew of specialists to help with the inmates.

This facility is unique in that the inmates are allowed outside on the facility to play baseball, football and basketball. The grounds are maintained by inmates and are a very clean well-kept site.

WEST VALLEY DETENTION CENTER

The West Valley Detention Center is located at 9500 Etiwanda Avenue, Rancho Cucamonga.

West Valley opened in 1991 and offers state of the art services in medical, culinary, transportation and housing. It is the largest low-rise center in California and is recognized as a flagship facility. The complex covers over 20 acres and presently houses over 3,000 inmates. It is the primary booking facility for San Bernardino County and averages about 5,000 bookings per month.

This facility also houses the Immigration and Customs Enforcement (ICE) unit that screens inmates for legal status and deportation holds. It has a large medical facility staffed with doctors and nurses. Some inmates at this unit have severe medical conditions. The medication dispensing system saves a great deal of time for the medical staff.

San Bernardino County Probation Department

JUVENILE DETENTION CENTER – SAN BERNARDINO

This facility is located at 900 E. Gilbert, San Bernardino, and was only one month old when visited. It was built on the property directly behind the old juvenile detention center. This facility houses twice the number of detainees as the old facility, approximately 280 juveniles. The ages of juveniles housed at the facility are between 12 and 18 but has housed juveniles as young as seven. The average stay is around 28 days. Some stay longer because of different circumstances, such as court order, waiting for placement, or being tried in an adult court. They are classified by age, type of offense, sophistication, body size, and gender. They are housed in pods, in a room with two beds. They go to school every day. Food is prepared at the site and brought to their individual pods. Shower and restroom facilities are within the pods.

A juvenile brought to the facility has an orientation where they are calmed down, evaluated, fed and classified. They then have an orientation of up to three days before taken to a pod.

All juveniles housed here are supervised by probation officers. Some juveniles housed at the facility have committed violent or serious crimes.

PUBLIC DEFENDER

Indigent Defense

BACKGROUND

The Constitution of the United States of America entitles all persons accused of a crime to a defense. Anyone not having the financial means to provide themselves with an attorney would be deemed indigent, and have an attorney appointed by the court. The responsibility for this representation falls under the Office of the Public Defender. When a case is referred to the Public Defender a minimal fee is charged. Although these fees are small, in some cases it is still beyond the client's ability to pay. Therefore there are provisions in place for these individuals to obtain a waiver. The fees charged by the County for Indigent Defense are recommended by the Office of the Public Defender and approved by the Superior Court. Once fees are assessed it is the responsibility of the County's Central Collections to collect the fees.

FINDINGS

1. The interaction and co-operation between the Court, Public Defender's Office and Central Collections has created an effective system of collecting indigent defense fees owed the county. After a client's case is resolved the sum of the fines, state fees and indigent defense fees are added together and this sum is collected over a three- to five-year period depending on the client's ability to pay. As fees are collected they are paid out in a specific order:

- (1) Victim's restitution
- (2) State Surcharge
- (3) Fines
- (4) Other Reimbursable Costs

Public Defender fees are in the “other reimbursable costs” and are among the last collected. Central Collections has tracked and reported that their collection rate is 70%-75%. They have several tools in place to collect delinquent accounts including wage garnishment and attachment of the individual’s state tax refund by the Franchise Tax Board.

2. The fees assessed in San Bernardino County for indigent defense

Fee Type	Calendar Year 2008	Calendar Year 2011
Misdemeanor	\$300	\$100
Felony	\$500	\$150
Juvenile	\$500	\$500

The Grand Jury could not find the reason for this change. After a comparison to other counties, it appears that San Bernardino County charges for indigent defense are too low.

Fees charged by some of the other California Counties for Indigent Defense

Los Angeles	\$51 to \$8,265
Lake County	\$100 to \$4,000
Riverside	\$90/hour
Del Norte	\$75/hour
San Luis Obispo	\$65/hour
Madera	\$33.50/hour

RECOMMENDATIONS

- 11-29 Raise indigent defense fees for adults back to \$300 for misdemeanors and \$500 for felonies. (Finding 2)

11-30 Have Central Collections continue to track the effectiveness of the recommended fee increase to support future fee adjustments. (Finding 1)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
Public Defender	11-29	September 30, 2011
Central Collections	11-30	September 30, 2011

PUBLIC AND SUPPORT SERVICES COMMITTEE

Becky Fults, Chair

Alfred J. Dubiel

Arnim Belke

Bob Mitchell

Dawn Molumphy

Ever Marie James

JoAnn L. Miller

Sylvia Olson

Wayne L. King



PUBLIC AND SUPPORT SERVICES COMMITTEE

Introduction

The County Public and Support Services Group (PSSG) was formed during a reorganization of the County, and approved by the Board of Supervisors in April 2005. The Public and Support Services Committee of the Grand Jury was assigned the responsibility of investigating the departments that provide services to the general public or internal support to other county departments. Those departments include:

Agriculture/Weights and Measures	Libraries
Air and Water Quality	Museums
Animal control	Public Works Department
Architecture and Engineering	Real Estate Services
County Airports	Regional Parks Department
County Fire Department and Fire Districts	Registrar of Voters
Environmental Health	Water Districts
Facilities Management Department	Cities/Municipalities
Fleet Management Department	Special Districts
Land Use Services Department.	School Districts and Community College Districts

Subcommittees were formed and the following departments/agencies were reviewed:

Code Enforcement	Seven Oaks Dam
County Fire	Solid Waste Management
Fleet Management	Transportation/Road
Parks and Recreation	Water Districts
Registrar of Voters	

Reports were written on:

City of San Bernardino - Parks and Recreation
Code Enforcement

CITY OF SAN BERNARDINO

Parks and Recreation

BACKGROUND

In November, 2011, members of the Grand Jury conducted a tour of the parks in the city of San Bernardino to investigate the general condition of parks in the inner city and outlying areas. Many parks in the inner city were found to be in a state of decline with dead or dying grass, shrubbery, and trees, along with graffiti, trash and debris. Also present was a homeless population living, squatting, and pan-handling.

Parks in outlying areas were found to be well maintained, with beautiful grounds, clean and an absence of homeless populations.

Grand Jury members met with the administration of the San Bernardino City Parks and Recreation Department to discuss the general state of decay and decline in some parks; and why this condition does not apply to parks in other parts of the city.

FINDINGS

1. In 2007 the department was under-funded by \$2 million. In 2009 the budget was cut by an additional \$2 million, allowing only one maintenance person per 60 acres. The standard is one maintenance person per 10 acres. The current budget is \$5.3 million. Expenditures from this budget are for maintenance, personnel, recreation, senior programs, human services and administration. City Parks and Recreation applied for statewide park development funding.

In areas where there are newer homes and parks, volunteers assist with park maintenance. Residents have pride in their parks. Older parks in other parts of the city have large homeless and transient populations.

2. The San Bernardino Police Department and the Parks and Recreation Department are aware of the homeless and transient populations.

RECOMMENDATIONS

- 11-31 Continue to seek funding and provide additional staffing for park maintenance personnel. (Finding 1)
- 11-32 San Bernardino Police Department to dissuade the homeless and transient populations from gathering in the parks. (Finding 2)

COMMENDATION

The Grand Jury commends Kevin Hawkins, Director of Parks and Recreation Department, and his staff for providing quality services, programs, and activities for the City of San Bernardino, despite the city's financial problems. The Parks and Recreation staff is committed to providing the residents of San Bernardino an opportunity to enjoy leisure and recreational activities.

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
San Bernardino City Council	11-31, 11-32	August 30, 2011

CODE ENFORCEMENT

BACKGROUND

County Code Enforcement is an organization that responds to, and investigates, code enforcement complaints. California law requires each County to develop and maintain a General Plan. The General Plan includes land development, protection of natural resources, and environmental issues. The General Plan also sets forth a series of rules (codes) prescribing how the plan is administered.

In San Bernardino County the Land Use Department is responsible for overseeing adherence to the General Plan through the Code Enforcement Division in the Land Use Department. The County Land Use Department had a reduction of 47 employees in the last two years. The Code Enforcement Division now has seven full-time code enforcement officers responding to citizen complaints.

In late 2009, a concerned citizen filed a complaint with the 2009-2010 County Grand Jury regarding alleged inappropriate removal of Joshua Trees, a protected species of plants under Federal and State law (1981 California Desert Native Plants Act – California Food and Agriculture Code Division 23, Chapter 3). Joshua Trees are a member of the lily family whose biological name is *Yucca Brevifolia*. It is native to the dry, sandy soil of the Mojave Desert, which stretches from Southern California into Arizona, Nevada and Utah. The plant has a bark-like trunk and can grow to heights of 15 feet or more. It can only grow in elevations of 2,000 to 6,000 feet Mean Sea Level (MSL).

Following a review of information received from the 2009-2010 San Bernardino County Grand Jury, this Grand Jury decided to investigate the code enforcement activities related to Joshua Trees. In early February 2011, a letter of inquiry from the Grand Jury to code enforcement officials of the desert cities of Victorville, Apple Valley, Hesperia and Twenty-nine Palms was sent seeking information about their activities with respect to the Native Plants Act (Joshua Trees specifically) and any statistics regarding violations.

In January 2011, the Grand Jury added illegal dumping and graffiti to its investigation after meeting with the County Code Enforcement personnel.

FINDINGS

Joshua Trees

1. The county receives approximately 400 code enforcement complaints per month. That number covers a variety of complaints, including Joshua Trees.
2. There are three code enforcement inspectors who respond to Joshua Tree code violations.
3. When a Joshua Tree code violator is caught, three courses of action may be taken:
 - criminal citation
 - administrative citation
 - civil remediation

The first two citations can result in fines up to \$500. Civil remediation requires a court appearance where more serious penalties may be imposed. There have been no civil court actions filed by the County in seven years.

4. When a Joshua Tree code violation involves only a few trees it is referred to the Environmental Planning Division of the Land Use Department. When clearing land for a major development, the Building and Safety Division responds. An inspector can issue a “stop-work” order on the project until the situation is resolved.
5. The County Code Enforcement Division does not keep a database of Joshua Tree code violations.

6. The City of Victorville has a Joshua Tree inspection application process in its code enforcement operation for the protection and preservation of the plant. There were no reported violations during the years 2007 through 2010.
7. The Town of Apple Valley enforces Joshua Tree protection under its Development Code (Section 9.76.040) which provides the criteria for a permit process to remove or relocate trees. A certified arborist must provide a written report on the condition, and any recommendation for removal of Joshua Trees. This report accompanies the permit application. Apple Valley furnished copies of code violations which resulted in citations and fines, but no totals for the years 2006 through 2010.
8. The City of Hesperia has a Protective Plant Ordinance (Municipal Code Chapter 16.24) which addresses the removal and relocation of Joshua Trees. Developers are required to prepare a Protection Plan for Plants which covers Joshua Trees and other species, after which a permit is issued for grading purposes. The Community Development Department (Building & Safety and Planning Division) inspects for compliance. Only one case of non-compliance was reported for the period of 2006 through 2010. A citation was issued and a fine paid for the violation.
9. The City of Twenty-nine Palms did not respond to the Grand Jury's request.

Illegal Dumping

1. The county has established a surveillance program of illegal dumping areas through the use of infrared video cameras. The cameras are set up to record activity in a given area. The county has 90 cameras available.
2. Violators of the county code against illegal dumping are identified through the license plate numbers at the scene, or faces of individuals present. The license

- plate numbers are traced through DMV records. When plate numbers are not visible, an image of the individual is used and put on a county poster circulated in the affected area. Local law enforcement agencies receive the poster and citizens can call a County 800 number.
3. Penalties for illegal dumping are much the same as other violations; criminal citations, administrative citations, or civil remediation. The most used penalty is the clean-up of the entire dumping site at the violator's expense.
 4. In cooperation with County and local fire departments, County Code Enforcement helps with removal of hazardous materials.
 5. Illegal dumping in county areas is handled by one county code enforcement officer.

Graffiti

1. The County receives approximately 43 calls a month regarding graffiti.
2. Enforcement of county codes against graffiti is handled through administration of two contracts (\$300,000 total) with private companies that specialize in graffiti issues. The contractors usually respond within 48 hours of a call and take photos of the graffiti before removal. The pictures are provided to the county and local law enforcement agencies to help to identify the perpetrators.
3. There is no single county code enforcement officer assigned only to the graffiti problem.
4. The county Code Enforcement Division does not keep a database on county graffiti code violations.

RECOMMENDATIONS

- 11-33 The County Code Enforcement Division staffing of code enforcement officers should be increased to adequately respond to the number of complaints. (Finding 2, 3 – Joshua Trees; Finding 1 – Illegal Dumping; Findings 1, 3 - Graffiti)
- 11-34 The County Land Use Department develop and maintain, for its Code Enforcement Division, a computerized system to properly document, categorize and retrieve information about county code violations by type. (Finding 5 – Joshua Trees; Finding 4 - Graffiti)
- 11-35 A uniform data exchange system be established between the county and the cities of Victorville, Hesperia, and the Town of Apple Valley in order to provide a more comprehensive picture of how laws are applied in County and local jurisdictions. (Findings 6, 7, 8 - Joshua Trees; Finding 2 - Graffiti)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
San Bernardino County, Code Enforcement Division	11-33 through 11-35	September 30, 2011
City of Victorville, Community Services	11-33, 11-35	September 30, 2011
City of Hesperia, Community Development	11-33, 11-35	September 30, 2011
Town of Apple Valley, Community Development	11-33, 11-35	September 30, 2011

RESPONSE ACCOUNTABILITY COMMITTEE

Melinda O'Connor, Chair

Alfred J. Dubiel

Arnim Belke

Bob Mitchell

Dawn Molumphy

Ever Marie James

Sylvia Olson



RESPONSE ACCOUNTABILITY COMMITTEE

Introduction

The Grand Jury formed the Response Accountability Committee to review responses to previous Grand Jury recommendations and determine whether compliance was achieved. The committee focused only on responses that the entities agreed to implement.

The results of these inquiries are contained in the attached report.

RESPONSE ACCOUNTABILITY

BACKGROUND

Each year Grand Juries are required by law to submit a Final Report to the presiding judge of the Superior Court. These reports, with appropriate recommendations, result from the investigations conducted by the Grand Jury. Each investigated entity must respond to the recommendations within the time period enumerated in California Penal Code, Section 933(c). Moreover, there is no statutory requirement that an entity actually implement a Grand Jury recommendation.

The 2010-2011 Grand Jury researched the last five years of responses and either met with the appropriate entity, or sent letters, asking if compliance was achieved. About 70% responded to the letters. In one incident, a department head disagreed with the response submitted on behalf of that department. It was determined that the response submitted for this department was actually finalized and submitted by the Public Information Officer for the County.

FINDINGS

1. Not all entities responded to the Grand Jury letters.
2. There is no statutory requirement or any policy or procedure that mandates that Grand Jury recommendations be implemented.
3. A response from a department was submitted by someone not from that department.

RECOMMENDATIONS

- 11-36 Establish a policy requiring implementation of any recommendation that was agreed to by a department. (Finding 2)

11-37 All responses be approved by the appropriate department head. (Finding 3)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
Board of Supervisors	11-36, 11-37	August 30, 2011

AD HOC COMMITTEE – SAN BERNARDINO INTERNATIONAL AIRPORT

Kent Fogleman, Chair

Arnim Belke

Becky Fults

Bob Mitchell

Ever Marie James

Melinda O'Connor

Allen “Skip” Burt



AD HOC COMMITTEE SAN BERNARDINO INTERNATIONAL AIRPORT

Introduction

In 2009, a complaint was received by the Grand Jury alleging irregularities at the San Bernardino International Airport (SBIA).

After some preliminary interviews of airport personnel, it became apparent that an extensive investigation was warranted, and the Ad Hoc Committee – San Bernardino International Airport was formed in August of 2009.

Because of the scope of the investigation, the 2009-2010 Grand Jury was unable to complete their investigation of the SBIA during their one year tenure. In order to continue the investigation, and maintain a smooth continuity for the incoming Grand Jury, several 2009-2010 Grand Jury members were selected to be a part of the 2010-2011 Grand Jury by the Presiding Judge, Douglas Elwell.

As more interviews were conducted and documents reviewed, the Grand Jury felt an independent Performance Audit was necessary. Bids were solicited and two firms responded. The auditing firm of Harvey M. Rose Associates, LLC was selected and hired with the approval of the Presiding Judge.

In December 2010, members of the Grand Jury and representatives of Harvey M. Rose met with SBIA airport officials to introduce the auditors to the airport officials and explain the purpose and scope of the audit.

The results of the audit are attached to this report.

SAN BERNARDINO INTERNATIONAL AIRPORT

BACKGROUND

The Norton Air Force Base was closed in 1994 and was converted to civilian and commercial use. The conversion and subsequent redevelopment of the base property and surrounding areas is governed by two Joint Power Authorities (JPA's):

1. The Inland Valley Development Agency (IVDA) was established in 1990 to handle the redevelopment of the non-aviation portion of the former air base. This includes approximately 600 acres on the former base and about 13,000 acres surrounding the base. IVDA board members are from San Bernardino County, and the cities of San Bernardino, Colton and Loma Linda.
2. The San Bernardino International Airport Authority (SBIAA) was formed in 1992 to oversee the approximately 1,300 acres of the aviation property of the former Air Force Base. SBIAA board members are representatives of San Bernardino County, and the cities of San Bernardino, Colton, Loma Linda, and Highland.

In 2002, the IVDA entered into a Master Disposition & Development Agreement (DDA) with Hillwood Investment Properties, a Texas-based development company to serve as the Master Developer of the project known as Alliance California. Several large companies are current tenants, including Stater Bros Market, Kohl's, Mattel, and Pep Boys.

In July of 2009, the Grand Jury received a complaint regarding alleged irregularities occurring at SBIA. An investigation was undertaken and after a number of interviews were conducted and many documents reviewed, it was determined that a Performance Audit should be initiated. The auditing firm of Harvey M. Rose Associates, LLC was hired. In December of 2010, the auditing team and members of the Grand Jury met SBIA

management to explain the purpose and scope of the audit; to answer any questions they had; to solicit their cooperation in setting up interviews, and providing the necessary documents necessary to complete the audit.

The audit evaluated a number of topics, including:

- The overall management structure and authority
- Internal control mechanisms
- Construction management policies
- Procedures and practices
- Leasing of hangars and terminal facilities
- Contractual and financial relationships between SBIAA and the various vendors and contractors

The audit report and recommendations (see Attachment #1) are incorporated by reference into the final report.

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
San Bernardino International Airport Authority Board	Section 1: 1.1 through 1.5 Section 2: 2.1 Section 3: 3.1 through 3.5 Section 4: 4.1 Section 5: 5.1	August 30, 2011

**Performance Audit of
San Bernardino International Airport
Operations, Development and
Construction Activities**

**Prepared for the
2010-2011 San Bernardino County Grand Jury**

By

**Harvey M. Rose Associates, LLC
1390 Market Street, Suite 1150
San Francisco, CA 94102
(415) 552-9292
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June 6, 2011

June 6, 2011

Bob Dunlap, Forman and Members of the
2010-11 San Bernardino County Grand Jury
351 North Arrowhead Avenue, Room 200
San Bernardino, CA 92415-0243

Dear Mr. Dunlap and Members of the 2010-11 San Bernardino County Grand Jury:

Harvey M. Rose Associates, LLC is pleased to present this *Performance Audit of San Bernardino International Airport Operations, Development and Construction Activities*. The audit includes a review of activities performed by the San Bernardino International Airport Authority (SBIAA), the Airport's contract managers and related support provided by the Inland Valley Development Agency (IVDA).

This performance audit was conducted in accordance with *Government Auditing Standards, July 2007 Revision*, by the U.S. Government Accountability Office, Comptroller General of the United States, as modified by directives from the Grand Jury to ensure investigative integrity. It contains five principal findings with recommendations to improve internal controls, construction management processes and equipment acquisition methods; strengthen due diligence processes related to potential litigation; and, reevaluate contractor relations.

We appreciate being provided with the opportunity to serve the Grand Jury during your term. We are available to assist you further on this matter or any other investigation that you might find appropriate.

Respectfully submitted,



Stephen Foti
Principal

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Executive Summary

Harvey M. Rose Associates, LLC was retained by the 2010-2011 San Bernardino County Grand Jury to conduct this *Performance Audit of San Bernardino International Airport Operations, Development and Construction Activities*. The audit included a review of activities performed by the San Bernardino International Airport Authority (SBIAA), the Airport's contract managers and related support provided by the Inland Valley Development Agency (IVDA).

To accomplish these objectives, Harvey M. Associates, LLC interviewed SBIAA management personnel, staff, and contractors; reviewed and analyzed SBIAA financial, planning, staffing, contract, and organizational documentation; reviewed SBIAA Commission and IVDA Board public records pertaining to Airport operations; and, reviewed data and documentation from the County of San Bernardino, the U.S. Department of Transportation, SBIAA contractors, and public record searches. Based on our research and analysis, we developed the findings and recommendations that are the subject of this report.

This performance audit was conducted in accordance with *Government Auditing Standards, July 2007 Revision*, by the U.S. Government Accountability Office, Comptroller General of the United States, as modified by directives from the Grand Jury to ensure investigative integrity. Specifically, the draft report received internal quality assurance review and was presented to the Grand Jury to obtain the member comments. However, at the direction of the Grand Jury, no exit conferences were held with SBIAA management prior to the release of the final report.

A summary of the findings and recommendations contained in this report are presented on the pages that follow, by report section number.

Section 1. Internal Controls

SBIAA has not established effective internal controls over financial management activities. The internal control foundation is weak, policies and procedures are neither current nor effective and business processes are poorly documented. The Commission should direct management to strengthen this internal control foundation over the next 12 months by establishing appropriate policies, procedures and business processes that protect the Authority's assets.

Although most major financial matters are brought before the Commission for consideration, the analysis supporting decision-making is often incomplete or vaguely stated. Authority for approving individual financial and contract transactions has been delegated to mid-level managers within the organization. In critical areas, the Authority's Chief Financial Officer has limited involvement in the initial review and approval of such transactions.

The Authority has secured the services of a local accounting firm to conduct its annual audit and various special compliance reviews. In some instances, the scope definitions for these reviews have been narrowed by management to exclude major areas of exposure. In addition, although we found no evidence of impropriety, the Interim Executive Director was a founding partner of

the accounting firm with which the Authority contracts. The Commission should adopt a policy requiring rotation of auditing firms every five years and solicit the services of other accounting firms through a competitive bid process to remove any appearance of an impairment to auditor independence.

Based on these findings, the SBIAA Commission should:

- 1.1 Direct management to develop comprehensive policies and procedures within 12-months of the receipt of this report.
- 1.2 Direct management to refine processes for ensuring the comprehensive documentation of business processes and transactions.
- 1.3 Convene a workshop to evaluate approaches to improving the quality and understandability of management reports to the governing board.
- 1.4 Adopt a policy to rotate financial auditing firms every five years.
- 1.5 Solicit proposals from qualified auditing firms to provide financial audit services for the next five year audit cycle.

There would be no cost to implement these recommendations.

If implemented, these recommendations would strengthen the SBIAA internal control environment. Documentation of internal control business processes and financial transactions would be improved. The SBIAA Commission would be provided with better information upon which to base their decisions. In addition, the appearance of impaired auditor independence would be reduced.

Section 2. Construction Management

SBIAA management proceeded with the Terminal Development and Fixed Based Operation (FBO) projects in a manner contrary to industry standards for large public infrastructure projects. Specifically, SBIAA management did *not* (1) conduct competitive bidding for general contractor services; (2) adhere to a clearly stated compensation structure for Norton Development Company, LLC (Norton Development) and SBD Properties, LLC (SBD Properties); (3) base the Terminal Building design substantially on transparent and methodical analysis of anticipated passenger traffic; (4) report a clearly defined budget to the SBIAA Commission throughout the project; and, (5) utilize clear and effective policies and procedures.

SBIAA management expedited and substantially increased the scope of the Terminal Development Project. These changes were based on assertions from the contractor with whom management intended to hire as the project developer through a sole source contract. This created a clear conflict of interest, since the developer has been paid on a percentage-of-project-cost basis and any increases in project cost leads directly to increased compensation for the

developer. Such changes were largely based on assertions by the contractor of (1) major commercial passenger air carrier interest in SBIA; (2) prospective air carrier infrastructure requirements; and, (3) more aggressive passenger traffic projections. The validity of these updated projections, interest, and demands are unclear and unsubstantiated. Further, the updated projections and resulting schematic design led to significantly higher costs, including \$9 million for a two-story concourse, over \$4 million for major aviation equipment, and \$2.7 million to fast track the project. Notably, the scope and cost of the Terminal Development Project grew incrementally from approximately \$22 million, based on an initial design in January 2006, to over \$100 million budgeted as of January 2011 with work and costs continuing to escalate.

Similar to the Terminal Project, SBIAA management allowed the same development contractor (through a separate company) to define the design and scale of the FBO project, leading to substantially higher costs. Likewise, the scope and cost of the FBO Project grew incrementally from \$5 million in March 2007 to over \$33 million as of January 2011, with approximately \$30 million actually expended as of that date.

SBIAA management has managed the Terminal Development and FBO Projects with insufficient controls. These control weaknesses have included: (1) the absence of sufficient policies and procedures; (2) the lack of an independent audit for either project; (3) poorly written leases that provide for little contractor oversight; and, (4) an opaquely written and implemented compensation structure for the two development companies.

Further, the projects' fund control process has (1) alienated the Chief Financial Officer from day to day financial oversight of major construction projects, and (2) resulted in poor budgetary controls.

Based on these findings, the SBIAA Commission should:

- 2.1. Immediately require SBIAA management to strengthen controls and reporting to the Commission including:
 - a. Implementing procedures for the use of contingency funds for existing and future capital projects.
 - b. Requiring Chief Financial Officer review and approval of all expenses prior to disbursement of capital project funds.
 - c. Enforcing all provisions in the Terminal and FBO leases requiring the developer to provide detailed monthly progress reports. The Commission should also require the developer to provide and present such reports at Commission meetings.
 - d. Engage the services of a reputable, independent auditing firm to examine all expenses incurred as a result of the Terminal Development and FBO Projects. The scope of such an audit should include a review of construction meeting minutes to determine if the developer purposely inflated costs.

There would be no cost to implement these recommendations.

If these recommendations were fully implemented it is more likely that Capital construction projects would be appropriately scoped, costs would be contained and transparently reported, and projects would be more economically implemented. Without immediate implementation of the recommendations, Norton Development and SBD Properties will likely continue to spend taxpayer funds without being subject to proper controls.

Section 3. Equipment Acquisition

SBIAA management did not conduct proper due diligence prior to purchasing used major aviation equipment from Norton Development for the terminal building. SBIAA management did not assess its equipment needs, determine whether the used equipment was appropriate, or send staff to visually inspect the equipment prior to authorization by the Commission. Further, SBIAA management did not consider or analyze the long term costs of purchasing used equipment versus the alternative of purchasing new equipment prior to proceeding with the acquisition.

The Interim Executive Director never executed a Sale and Purchase Agreement with Norton Development despite multiple assertions to the Commission that he would do so and several references in the authorizing resolution indicating that such an agreement would be executed. In lieu of an executed contract, the terms of the agreement were later stated in a series of two letters from the Manager of Norton Development to the Interim Executive Director. The terms of these letters were substantially different from the representations made to the Commission by the Interim Executive Director.

SBIAA has insufficient controls, including policies, procedures, and audits for use when acquiring aviation equipment. SBIAA management has not set up an internal process for verifying price, quantity, or condition of the used aviation equipment that is being acquired from Norton Development. Further, the fund control process is inadequate for ensuring that SBIAA receives a fair and accurate price for the used equipment. Additionally, there have been no audits conducted of the used aviation equipment.

Based on these findings, the SBIAA Commission should:

- 3.1 Make a formal policy decision to only authorize contracts after they have been signed, on condition of Commission approval, so that it can properly review such contracts and to ensure that all major agreements are accompanied by signed and executed contracts.
- 3.2 Formally approve a purchasing policy that includes revisions to address the deficiencies identified in our review. In particular, eliminate the *Negotiated Purchases* section of the purchasing policy and require that all purchases above \$25,000 (or a different threshold deemed more appropriate by the Commission), regardless of purpose, require a formal contract to be approved by the Commission.
- 3.3 Set a regular schedule for reviewing, revising, and formally approving updates to the purchasing policy.

- 3.4 Engage the services of a reputable, independent auditing firm to examine the representations and warranties made by Norton Development management and SBIAA management in connection to the purchase of used aviation equipment as well as the amount actually spent on such equipment, and the estimated useful life and/or resale potential of the equipment.
- 3.5 Formally direct the Interim Executive Director and Assistant Director to cease from approving any further fund payments to Norton Development or any third parties with agreements to provide services in connection to the used aviation equipment, which was originally authorized on July 3, 2007.

There would be no cost to implement these recommendations.

The SBIAA Commission could save taxpayers at least an additional \$134,689 if the Commission were to refuse to fund the 11th jet bridge currently being refurbished out of state. Taxpayers would also not have to pay for the developer and construction management fees as well as offloading and installation costs associated with this jet bridge.

Section 4. Lawsuit Settlement

On July 23, 2008, SBIAA entered into a lease agreement with Norton Aircraft Maintenance Services, Inc. (NAMS) for Hangar Bay No. 695. However, this hangar had previously been leased to another company pursuant to an agreement dated June 3, 2008, which was extended through August 23 on a day-to-day basis. This resulted in conflicting occupancy rights that led to a dispute between the tenants and a claim for damages against SBIAA by NAMS and SBD Aircraft Services, LLC (SBD). The latter company had contracted with NAMS for a Federal Aviation Administration (FAA) inspection and maintenance service on a Boeing 727 aircraft that it intended to lease to a third party. In response to the claim for damages, SBIAA agreed to a monetary settlement with the two companies amounting to approximately \$1 million.

The Settlement and Mutual Release Agreement between SBIAA and Norton Aircraft Maintenance Services (NAMS) jointly with SBD Aircraft Services was executed less than seven weeks after the lease between SBIAA and NAMS had been signed, and only 18 days after the claim for damages was submitted to the Airport by NAMS and SBD. SBIAA management did not compel either NAMS or SBD to submit documentation to objectively assess the appropriateness of the claim for damages or challenge the original amount of the claim in any meaningful way. Notably, this settlement was amicably reached in a short time period, even though the lease agreement with NAMS included language intended to completely indemnify SBIAA from “consequential or punitive damages” in the event of default.

Further, SBIAA did not require an independent appraisal of the aircraft, including the airframe and jet engines, which were pledged as collateral for the loan prior to disbursing funds. By failing to conduct an appraisal, SBIAA can not be assured that SBD will have financial resources that are sufficient to repay the loan amount of \$550,000.

At the very least, the expedited nature of this agreement and the lack of due diligence by SBIAA to verify the existence or extent of damages or independently obtain an opinion of value of the collateral pledged for the loan make the appropriateness of the settlement questionable. In addition, the settlement resulted in substantial cost to the taxpayer, which may be greater if SBD defaults on the loan and the market value of the aircraft used as collateral is not sufficient to repay the balance of the debt owed to SBIAA.

Based on these findings, the SBIAA Commission should:

- 4.1. Engage the services of a reputable, independent auditing firm to examine the representations and warranties made by NAMS and SBD management in connection with the *Settlement and Mutual Release Agreement* and, if found to be false or untrue, demand immediate repayment of the Insurance Loan, Rent Credit and Temporary Aircraft Rehabilitation Loan balance.

If the representations made by NAMS and SBD are found to be false or untrue, taxpayers would be reimbursed the cost of the *Settlement and Mutual Release Agreement*, amounting to \$440,000 in loan forgiveness and rent credits, and would receive immediate repayment of the balance due on the \$550,000 loan to NAMS and SBD.

Section 5. Contractor Relations

SBIAA has entered into multiple contracts with companies managed by a single individual, Scot Spencer. Mr. Spencer is a convicted felon who served time for bankruptcy fraud in a federal penitentiary and, in a separate matter stemming from businesses he managed at San Bernardino International Airport, was ordered by the United States Department of Transportation (DOT) to “permanently cease and desist from further marketing or other involvement in air transportation operations so that he is banned from the aviation industry.” Mr. Spencer was ordered to pay civil penalties of \$1.0 million, which remain unpaid.

Mr. Spencer’s history at SBIAA began in approximately 2003 as a manager of KCP Leasing & Services, LLC, which was leasing space for the storage of Boeing 727 aircraft. Over the years, his involvement with SBIAA has grown, until Norton Development Company, LLC and SBD Properties, LLC (SBD) – two other companies that he manages – were granted development contracts to construct a new Terminal and a Fixed Base Operator (FBO) facility at the airport. The initial combined cost estimate for these two projects was about \$43 million, but through January 2011, SBIAA had spent over \$125 million on the projects. Companies affiliated with Mr. Spencer received payments of \$7.4 million in developer fees, based on a percentage of total costs, and reimbursement of nearly all of their direct and indirect costs through that date.

As the development projects progressed, Mr. Spencer’s companies were given responsibility for managing major aspects of airport operations. After approaching the Interim Executive Director with an informal proposal, Mr. Spencer was able to obtain agreement from a nationally recognized company to participate in FBO services at the airport. Mr. Spencer then gathered investors to open a franchise of that company, which he now manages, named *Million Air San*

Bernardino, LLC. Subsequently, SBD was then awarded a 25-year lease to provide FBO services and run the airport fuel farm through *Million Air San Bernardino, LLC*.

SBIAA had also solicited proposals for a nationally recognized airport management company to operate the airport, but no responses were received. As an alternative, the Interim Executive Director negotiated a sole source contract with Mr. Spencer through San Bernardino Airport Management, LLC (SBAM), which Mr. Spencer formed for that purpose and now manages. Compensation for SBAM under a 25-year agreement with SBIAA guarantees payments of \$500,000 per year, reimbursement of most major operating costs, and the receipt of 50% of net operating income. SBIAA absorbs all financial risk.

The evolution of these sole source relationships between SBIAA and Mr. Spencer, and the growth in the involvement of the companies he manages, raises serious questions. Further, Mr. Spencer's activities at SBIAA are in direct violation of the DOT order, which states he should be "banned from the aviation industry."

Based on these findings, the SBIAA Commission should:

- 5.1. Direct staff to review current contracts for construction services and Airport operations with the companies he manages to identify modifications that may be necessary to protect the IVDA and SBIAA from potential future risk.

There would be no cost to implement this recommendation.

SBIAA would limit exposure to the types of difficulties described throughout this report and would no longer be party to Mr. Spencer's apparent violation of the DOT order banning him from the aviation industry.

Introduction

Harvey M. Rose Associates, LLC is pleased to present this *Performance Audit of San Bernardino International Airport Operations, Development and Construction Activities*. This performance audit was conducted for the San Bernardino County Grand Jury pursuant to its authorities defined in California Penal Code Section 925, et seq.¹

Study Purpose and Scope

The Grand Jury requested this performance audit to evaluate the efficiency, effectiveness and economy of the San Bernardino International Airport Authority (SBIAA), focusing on governance and general management, as well as development, construction, contracting and related activities performed by SBIAA managers and their contractors. Specifically, the Grand Jury asked that the following topics be evaluated at SBIAA.

1. The management structure and authorities, including governance and staffing levels, decision making authorities and processes, as well as performance and financial management.
2. Internal control mechanisms established by SBIAA to determine whether appropriate monetary safeguards have been established and are followed, and whether the organization complies with generally accepted accounting practices in regards to recording and reporting on certain financial transactions.
3. Construction management policies, procedures and practices, to ensure that they comply with federal and State laws and regulations; incorporate fair and transparent bidding and contractor selection processes; and appropriately safeguard the financial interests of the organization and taxpayers.
4. The leasing of hangar and terminal facilities, and the process for awarding service contracts, including the master lease and operating agreements.
5. The contractual and financial relationships between SBIAA and their contractors to determine the role of each; examine ownership and management composition; and, investigate how each was selected or became involved with airport construction and/or management activities.
6. The master lease agreement, including the responsibilities of the lessee (e.g., operations and development, airport promotion, etc.) and compliance with lease terms.

¹ California Penal Code Section 925 states, “The grand jury shall investigate and report on the operations, accounts, and records of the officers, departments, or functions of the county including those operations, accounts, and records of any special legislative district or other district in the county created pursuant to state law for which the officers of the county are serving in their ex officio capacity as officers of the districts.”

Methodology

We conducted the performance audit in accordance with *Government Auditing Standards, July 2007 Revision*, by the U.S. Government Accountability Office, Comptroller General of the United States, as modified by directives from the Grand Jury to ensure investigative integrity. In accordance with these modified standards, we performed the following key activities and tasks:

- We held an entrance conference with the executive staff from the San Bernardino International Airport Authority to introduce HMR staff, describe the performance audit process and protocol, and request general information on the organization, development and operations of the airport.
- We conducted an initial assessment of SBIAA administration and operations in accordance with project goals defined in our initial work plan and subsequent communications with the Grand Jury. During this initial assessment phase, we interviewed SBIAA management staff, including the Interim Executive Director, the Assistant Director, the Chief Financial Officer, the Aviation Director, the Redevelopment and Transportation Director, the Clerk of the Board/Director of Information Services, and SBIAA's legal counsel. Four formal information requests were submitted to SBIAA management and documentation was provided through an File Transfer Protocol (FTP) web site established to transmit materials. In addition, a tour of the redevelopment area and airport property was conducted to gain perspective on the project and development. At the conclusion of these activities, we met with the Grand Jury and developed a more detailed plan for conducting our subsequent performance audit activities.
- We conducted field work to further refine our understanding of the topics under review. The field work involved additional interviews of SBIAA managers and other individuals with knowledge about SBIAA operations, including the contractor who has been involved in many of the development and operations activities at the airport. Additional information and documentation was collected and analyzed. At the conclusion of field work activities, we developed preliminary findings, conclusions, and recommendations.
- We produced a draft report for internal quality assurance review purposes and presented the draft report to the Grand Jury. At the direction of the Grand Jury, no exit conferences were held with SBIAA management prior to the release of the final report.

Background

The San Bernardino International Airport was formed in 1992 after the closure of Norton Air Force Base and converted to civilian and commercial use. The conversion and subsequent redevelopment of base property and surrounding areas is overseen by two joint power authorities (JPAs):

- The Inland Valley Redevelopment Agency (IVDA) and,
- The San Bernardino International Airport Authority (SBIAA).

The two JPA governing boards include representatives from five area jurisdictions, including: (1) the County of San Bernardino, (2) the City of San Bernardino, (3) the City of Colton, (4) the City of Loma Linda, and (5) the City of Highland. With the exception of Highland, all of these entities are represented on both of the JPA governing boards. The City of Highland is a member of SBIAA but not IVDA.

The stated objectives of the two JPAs is to “replace the jobs lost in the community when the base closed, improve the infrastructure, landscape and aesthetics of the local and surrounding areas, and promote economic and aviation related activities to increase the tax base of the region.” SBIAA is responsible for the aviation portion of the Norton Air Force Base (approximately 1,300 acres). IVDA is responsible for the redevelopment of the non-aviation portion of the former Norton Air Force Base (approximately 600 acres) and a surrounding redevelopment project area (approximately 13,000 acres). The land use designations within the project area include light and heavy industrial, office, commercial and residential uses.

Organization and Staffing

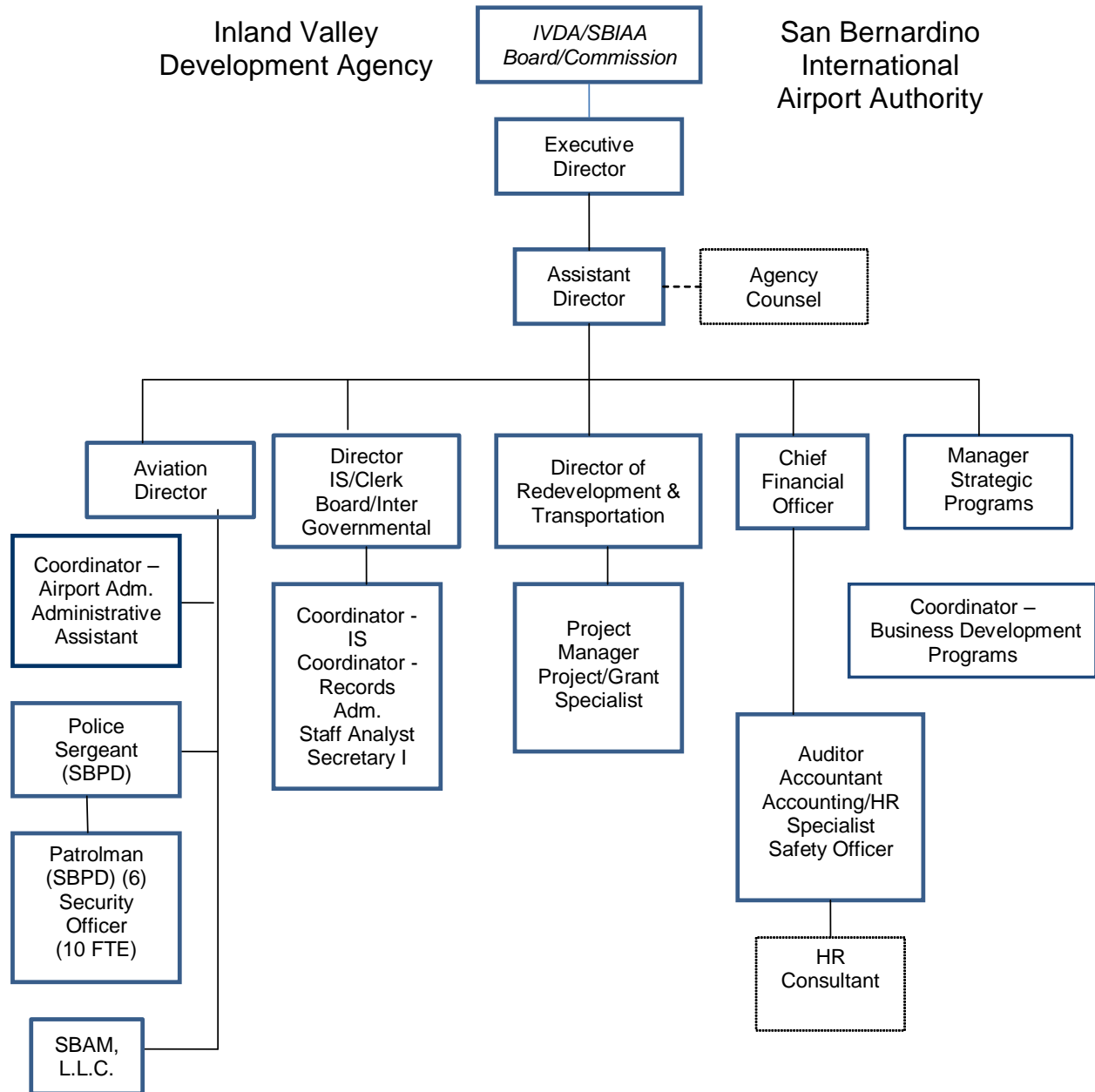
The Inland Valley Development Agency and the San Bernardino International Airport Authority have a merged organization that includes the following major divisions:

- The Executive Office, which is staffed by the Interim Executive Director and the Assistant Director. The Agency Counsel, which is provided by contract through Lewis, Brisbois, Bisgaard & Smith, LLP, reports to the IVDA Board and SBIAA Commission through the Executive Director.
- Aviation, which is staffed by an Aviation Director who oversees Marketing and Leasing; Airport Security, which is staffed with officers from the San Bernardino Police Department and Security Officers; and, the San Bernardino Airport Management (SBAM) contract for airport operations.
- Information Systems and Clerk of the Board, which is staffed by the Board Clerk as well as secretarial, records clerk and staff analyst positions.
- Redevelopment and Transportation, which is staffed by a division director, project management and grant specialist personnel.
- Finance, which is staffed with a Chief Financial Officer, accounting and human resource personnel.

In FY 2010-11, the IVDA Board and SBIAA Commission authorized a total personnel budget of \$4,970,467 to fund a total of 59.3 positions. All of these personnel were hired through third party contracts with other organizations (i.e., the Interim Executive Director and the Aviation Director, through companies they had formed; Agency Counsel, through an established law firm; and personnel hired under the San Bernardino Police Department and San Bernardino Airport Management, LLC), or on individual contracts. All personnel, whether hired through third party contracts or individual contracts are at-will employees, exempt from civil service. An organization chart for the combined IVDA and SBIAA is provided on the next page.

Exhibit 1

Combined IVDA and SBIAA Organization Chart



4/2011

Source: SBIAA Accounting Policy and Procedures

Airport Development Activities

In 2002, IVDA entered into a Master Disposition and Development Agreement (DDA) with Hillwood/San Bernardino LLC, which “serves as the master developer of the project commonly known as Alliance California.” Under this DDA and separately on individual projects, IVDA successfully developed large warehouse and business centers occupied by Stater Bros., Mattel, Pep Boys, Kohls, and other commercial enterprises, generating local job opportunities for the community and substantial property tax increment for IVDA. Once the property tax increment began to be generated, the IVDA Board directed funding toward the development of the airport properties deeded over from the federal government. The property tax increment revenues, as well as certain grant and other funding, were also used to develop basic infrastructure in the redevelopment area, such as streets, sidewalks and sewers.

In the initial years, most activities at the airport involved efforts to secure title to the property, remove waste and hazards, and conduct other similar activities. According to SBIAA management, development plans produced in the late 1990s focused on a primary goal of developing international air cargo services, with some charter airline and general aviation services being offered at the airport. Over time, the conceptual framework for the airport changed, and in the mid-2000’s decisions were made to focus on commercial airline services and general aviation, with some air cargo services. As a result, SBIAA decided to engage in two major development projects: (1) The development and construction of Fixed Base Operator (FBO) facilities with the goal of attracting a nationally recognized FBO operator to the airport;² and, (2) the development and construction of a commercial passenger terminal with the goal of attracting regional, national and international airlines to the airport.

FBO Development Project

The FBO project was initiated in 2007 by SBIAA through an agreement with SBD Properties, LLC, a company managed by Scot Spencer, a lessee who occupied a portion of Hangar No. 763 through another company he managed at the time. As a condition of being awarded the FBO development project, SBD Properties, LLC was required to secure a contract with a nationally recognized FBO operator who would provide aircraft services at the airport. To meet this condition, Mr. Spencer formed *Million Air San Bernardino, LLC*, a franchise of *Million Air Interlink*, which is a nationally recognized FBO operator based in Houston, Texas.

Initial estimates made to the SBIAA Board of Commissioners in a March 14, 2007 staff report indicated that the total project cost for “a new FBO building to include executive offices, pilot lounges and other amenities” would cost SBD Properties, LLC an estimated \$5 million “at its own expense”.³ Shortly thereafter, on March 23, 2007, SBIAA entered into an *Agreement for*

² FBO services include: aircraft fueling, large aircraft maintenance, indoor and outdoor long-term parking for general aviation aircraft, ground handling, flight school, passenger services (including catering), gratuitous passenger transportation services, emergency services for disabled aircraft, aircraft parking and landing fee collections, and ground and building maintenance.

³ March 14, 2007, Item No. 10, *Adopt Resolution No 2007-0, etc.*, Michael Burrows, Assistant Director.

Acquisition of Improved Building with SBD Properties, LLC to purchase the FBO facility after construction was completed, for an amount “equal to or less than \$9,000,000.”

At the beginning of this project, the *Million Air Interlink* website described the San Bernardino project, as follows:

This new facility contains 40,000 square feet that not only consists of standard Million Air amenities, but also executive office space, hangars (sic) space and more. Million Air San Bernardino will provide exceptional service with unprecedented luxury and offers onsite customs for passengers traveling abroad. Million Air San Bernardino is on schedule to be open June 2010.

Beyond the standard Million Air amenities, this location has much more to offer. Hangar #1 features 6,747 Square feet of executive office space. This hangar has a 28 foot high door and offers a total of 29,000 square feet. Hangar #2 features 30,000 square feet with a 50 foot high hangar door and offers 7,000 square feet of executive office space along with 40 secured tenant parking spaces. All executive space can be built to suit as needed and with plenty of land and space available, we are sure that we can accommodate your business needs. On top of everything else Million Air has to offer, there is also a brand new 150,000 gallon fuel farm, state of the art technology, and high security. With a 10 acre ramp, Million Air San Bernardino is ideal for a single private client or a corporate flight group.

After construction was underway, SBIAA expanded the contract scope to include the development of various other facility improvements, including improvements to Hangar No. 674 for use by *Million Air San Bernardino* and the construction of a United States Customs Building. The Customs Building was still under construction at the time of this performance audit.

Because the project cost escalated and other capital improvements were added, the initial project cost estimate rose substantially. Based on financial documents reviewed for this performance audit, the total disbursements for the FBO project amounted to approximately \$29.7 million, as of January 25, 2011, including \$1,233,621 in payments to SBD Properties, LLC. This amount included developer fees paid to SBD Properties, LLC of 2.0%, of total project costs, or approximately \$580,000.

Terminal Development Project

A *Terminal Lease* agreement was also entered into in 2007 between SBIAA and Norton Development Company, LLC, another company managed by Scot Spencer. This agreement established the terms and conditions of constructing the passenger terminal building at the airport, which included the renovation of an existing terminal building that had been used by the Air Force and new construction on three acres of surrounding land area. The lease agreement estimated that the total project cost would amount to approximately \$38 million for the construction of a terminal with three gates and jetways, one hardstand ground level passenger boarding area, passenger lounges and other features. The actual agreement capped costs at \$45 million, stating that if costs exceeded this amount, the “Seller and Purchaser” would meet in good faith to reduce the amount.

In March 2009, the scope of the agreement was amended with additional improvements, including: a parking lot with landscaping, a flight kitchen, an airline food handling and maintenance area, equipment, roadway and entry monument signs, airport security fencing and

gates, security systems and devices, apron and taxiway striping and other miscellaneous projects. With this addition, the maximum project cost was capped at \$61,000,000.

Based on a review of disbursements for the terminal project through January 2011, SBIAA had already expended approximately \$96 million on the project, including approximately \$4.4 million that had been paid to Norton Development Company, LLC. Of this amount, 1.35% of the \$96 million in construction costs was paid to Norton Development Company, LLC as a developer fee, amounting to approximately \$1.3 million.

Airport Operations

In December 2009, SBIAA entered into an *Airport Management and Development Agreement* with San Bernardino Airport Management, LLC (SBAM), a company managed by Scot Spencer. Under the terms of this agreement, SBAM is required to develop business plans and budgets for airport operations, and manage and operate the airport. Management and operations responsibilities are broad, and include: (1) employing a person designated as “Airport Manager;”⁴ (2) developing opportunities and managing leases of airport property; (3) promoting and marketing commercial air service operations; (4) recommending regulations and operating standards to SBIAA management; (5) providing finance and accounting services; (6) maintaining and repairing facilities and equipment; (7) overseeing airport support functions and contracts with third parties; and, (8) performing other related functions.

In exchange for these services, SBAM is to be reimbursed the direct and indirect cost of operating the airport and receive the following compensation:

- Payment for the “Airport Manager” at a rate of \$250,000 per year, increased annually for inflation at a rate of three percent;
- Payment for “Management Compensation” at a minimum of \$250,000 per year, or 50% of Net Income, as defined in the agreement; and,
- Payment of a “Commercial Airline Start-Up Fee,” to be paid within 30 days after a commercial passenger airline announces service at the airport.

As of the date of this report, no commercial passenger airline has announced an intention to operate out of San Bernardino International Airport.

⁴ Amendment No. 1 to the agreement requires SBAM to retain the services of a “nationally or internationally recognized airport management company,” which is presently named as AFCA/AvPorts. The current Airport Manager is an employee of this company.

Acknowledgements

Harvey M. Rose Associates, LLC would like to thank the Grand Jury for their participation and counsel during this performance audit. In addition, we would like to thank personnel from SBIAA and others for their insight into airport development and operations. In particular, we would like to thank the Clerk of the Board and her staff for their extraordinary effort compiling and indexing the many documents required for this review.

1. Internal Controls

- **The San Bernardino International Airport Authority has not established effective internal controls over financial management activities. The internal control foundation is weak, policies and procedures are neither current nor effective and business processes are poorly documented. The Authority's Commission should direct management to strengthen this internal control foundation over the next 12 months by establishing appropriate policies, procedures and business processes that protect the Authority's assets.**
- **Although most major financial matters are brought before the Commission for consideration, the analysis supporting decision-making is often incomplete or vaguely stated. Authority for approving individual financial and contract transactions has been delegated to mid-level managers within the organization. In critical areas, the Authority's Chief Financial Officer has limited involvement in the initial review and approval of such transactions.**
- **The Authority has secured the services of a local accounting firm to conduct its annual audit and various special compliance reviews. In some instances, the scope definitions for these reviews have been narrowed by management to exclude major areas of exposure. In addition, although we found no evidence of impropriety, the Interim Executive Director was a founding partner of the accounting firm with which the Authority contracts. The Commission should adopt a policy requiring rotation of auditing firms every five years and solicit the services of other accounting firms through a competitive bid process to remove any appearance of an impairment to auditor independence.**

Internal control is comprised of the “plans, policies, methods, and procedures used to meet the organization’s mission, goals, and objectives. Internal control includes the processes and procedures for planning, organizing, directing and controlling program operations, and management’s system for measuring, reporting, and monitoring program performance.”¹

There are accepted standards of internal control for any organization, as described by the U.S. Government Accountability Office from guidance that it obtained from *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).² Three key standards are described below.

¹ July 2007, *Government Auditing Standards*, United States General Accounting Office by the Comptroller General of the United States, Standard 1.30.

² November 1999, *Standards for Internal Control in the Federal Government*, United States General Accounting Office (renamed General Accountability Office since publication)

1. Control Environment: The organizational principles, policy expectations and approaches to core business activities.
2. Control Activities: Ensures that management's directives are carried out.
3. Control Monitoring: Assesses the quality of performance over time.³

Throughout this report, the audit discusses circumstances that point to weak internal controls within the SBIAA organization. Although the internal control review was limited in scope, efforts were made to focus on the fundamentals of maintaining a strong internal control environment and protecting taxpayer assets with effective control processes, procedures and monitoring systems. This section discusses aspects of the internal control environment, control activities and SBIAA's principal monitoring mechanisms that are not addressed elsewhere.

Policy and Procedure Foundation

Fundamental to an effective internal control system is the communication of management policies and a procedural foundation that describes how business is to be conducted. This performance audit found the state of policies and procedures within SBIAA to be variable, but generally poor. Only two policies and procedures were made available immediately at the outset of the performance audit. These were for: (1) Personnel, and (2) Purchasing. Other policies and procedures emerged as the audit progressed, while still others were never produced.

Personnel Policies and Procedures

The most comprehensive policy and procedure provided by SBIAA relates to Personnel management, which was approved by the IVDA Board for both entities in early 2010. This document is better constructed and contains more detail than other policies and procedures documents provided by SBIAA for this performance audit. The document appears well researched, is well organized, and addresses most basic areas of personnel management within organizations with the characteristics of IVDA and SBIAA.

Notably, the Personnel Policy and Procedure Manual was prepared for purposes of defining a new relationship between the IVDA and SBIAA organizations and employees, who became at-will contract personnel during the period of implementation. Policy III, Section 1 states, "All IVDA/SBIAA positions are filled on a contract basis. All employees shall be considered at-will and serve at the pleasure of the Executive Director." Due to this major shift in the organizations' relationship with its workforce, management reportedly felt that policies and procedures needed to be well defined to ensure that this relationship was clearly communicated to staff. Should the structure and approach to staffing evolve, these policies and procedures should be revised to reflect any changes in the organizations' relationship to personnel.

³ Ibid

Purchasing Policies and Procedures

The Purchasing policies and procedures were last updated in May 2003, approximately eight years ago, before major development at the airport and the acquisition of expensive fixed assets occurred. The document provided for this assessment appeared to be undergoing modifications at the outset of this audit, since the version that was provided contains many underlined additions and strike-through deletions.

Even with the modifications, the Purchasing policy and procedures are vague and incomplete. For example, the section on negotiated purchases states,

Negotiated purchases must be authorized by the Executive Director. This method will be used only when most advantageous to the Agency. A written report will be submitted to the Executive Director describing the circumstances and terms of the contract.

As described extensively in Section 3 of this report, SBIAA has used the negotiation process to acquire expensive equipment for the Terminal and Fixed Base Operator (FBO) construction projects, which have raised several questions regarding whether the purchases were “advantageous” to the Authority. In this example, the criteria and methodologies to be used for measuring the appropriateness of a negotiated purchase should be better defined.

Accounting and Financial Reporting Policies and Procedures

As stated by the Government Finance Officers Association (GFOA) when describing best practices, “Communication is an essential component of a comprehensive framework of internal controls. One method of communication that is particularly effective for controls over accounting and financial reporting is the formal documentation of accounting policies and procedures. . . . Every government should document its accounting policies and procedures.”⁴

At the beginning of this performance audit, management was asked to provide copies or access to all of the SBIAA policies and procedures. At the time, no accounting policies and procedures were provided, but the auditors were advised by the Chief Financial Officer on December 29, 2010 that such policies and procedures were under development in anticipation of the audit and would be provided to the auditors in draft form within a week. Auditors were advised that the policies and procedure documents would address Accounts Payable, Accounts Receivable, Payroll and Bank Account Reconciliation processes. On January 4, 2011, SBIAA posted Accounts Receivable, “Cash, Receivable & Revenue,” “Financial Accounting System,” and Payroll policies on the File Transfer Protocol (FTP) web site established for the performance audit. No Bank Account Reconciliation policies and procedures were posted.

In sharp contrast to the *Personnel Policies and Procedures* discussed previously, these documents were brief, incomplete or unclear in some areas, and undated and unsigned by management. For example, the full text of the procedure contained in the *Financial Accounting System Policy* states the following:

⁴ March 2, 2007, *Best Practice Documentation of Accounting Policies and Procedures (2002 and 2007)* (CAAFR)

The Agencies use MASS90 (sic). MAS90: is a commercially available program similar to Quickbooks. The user cannot modify the source code. The controls in MAS90 are tighter than Quickbooks. The user cannot delete transactions after they are recorded, or modify them.

The Agencies use the San Bernardino County Payroll System to process payroll, thus controls used by the County have a significant influence on the Payroll Transaction Class.

The Agencies use a third party payroll service (Apple One) for part time employees.

These procedures do not provide information on how to access the system, or references that would effectively incorporate system manuals or other critical documentation into the procedure (e.g., in the case of the payroll system, a statement is made that the Agencies use the County payroll system, but there is no reference to the County's policies and procedures, how IVDA/SBIAA interfaces or applies the County system, or how the County system may be used to deal with the unique relationship between IVDA/SBIAA and its personnel). The policy and procedure document provided for the performance audit is undated and unsigned, and provides no evidence of management review or approval.

Understanding that these were draft, on April 12, 2011, the auditors were provided with a more formal *Accounting Policy and Procedure Manual* that appears to have been completed in March of this year. This document has several of the same deficiencies found in the January drafts, but includes additional sections on General Policies, Purchasing, Human Resources, Budget, Financial Reporting, Grants, Risk Management and other topics not previously shown. Notably, this document focuses on statements of the organizations' policies and provides only general overview descriptions of related procedures. Exhibit A (Purchasing Policies) and Exhibit B (Investment Policies) are missing, and thus the document provided for the performance audit was incomplete.

Other Policies and Procedures Do Not Exist

There are several other areas where comprehensive policies and procedures would enhance the airport's internal control foundation, but which do not exist, according to individuals interviewed for this performance audit. One critical area involves the safeguarding of physical assets.

Since the airport has constructed major facilities and acquired expensive equipment in the last several years, it is important that policies and procedures for inventory and fixed asset control be developed, be comprehensive and clear, and be fully implemented by the Authority. However, these policies and procedures do not exist and, based on fieldwork activities related to the acquisition of equipment for the Terminal and FBO facilities, inventories appear to be neither comprehensive nor routine. In addition, SBIAA has not established effective policies and procedures related to the security of assets. The Authority instead relies upon general safety and security policies and procedures established by the City of San Bernardino Police Department in its role as contract security for the facility.⁵ These policies and procedures are dated May 1996,

⁵ The Aviation Director stated that security procedures are being reviewed by the federal Transportation Security Agency (TSA) and are confidential. However, the Authority has not established interim security policies and procedures or procedures regarding the safeguarding of assets owned by the airport and its tenants.

prior to the terrorist attacks of September 11, 2001 and before increased airport security became a national priority. No emergency preparedness plan, which would contain policies and procedures regarding the safeguarding of persons and property in the event of a disaster or other emergency, was provided for the audit.

Further, various operational policies and procedures affecting internal control at the airport have not been developed or were not provided by management. Vehicle management, vehicle fuel dispensing, contract management, contractor monitoring, and other similar policies and procedures were not provided for this audit, even though requests were made for SBIAA to provide copies of or access to all policies and procedures that govern its operations. To ensure that SBIAA has a strong internal control foundation, the Commission should direct management to develop comprehensive policies and procedures within 12-months, or as quickly as possible, but certainly before commercial airline passenger service is initiated at the facility.

Business and Financial Process Documentation

Procedures provide a general framework for how business should be conducted. It is also important that specific business processes and transactions be well documented to provide a basis for monitoring employee and contractor compliance with established policies and procedures, Board authorizations, and management directives. As discussed throughout this report, the audit of a limited number of major transactions illustrates the weaknesses in SBIAA's current systems. Some examples are described, below.

Adherence to Contracting Policies: As discussed in Section 5, IVDA and SBIAA have entered into sole source contracts with private companies, managed by a single individual named Scot Spencer, to construct nearly every major facility and other improvements at the airport. The cost of the projects awarded to Mr. Spencer's companies amounted to over \$125 million through January 2011. Of this amount, \$7.4 million was paid directly to the companies affiliated with Mr. Spencer in management fees and for direct reimbursement of costs.⁶

The two projects for which Spencer affiliated companies were retained, were the Terminal Project, for which Norton Development Company, LLC charged developer fees of 1.35% of total project costs; and, the FBO Project, for which SBD Properties, LLC charged developer fees of 2.0% of total project costs. Total developer fees of approximately \$1.9 million were paid for the two projects. The remaining amount of approximately \$5.5 million was paid as direct reimbursement of costs incurred by these and other Spencer affiliated companies, including reimbursements for actual staff time spent by Mr. Spencer and his other employees.

⁶ The construction of the FBO and customs building, as well as improvements to other areas of the airport, were awarded to SBD Properties, LLC for total project costs of \$29.7 million through January 2011. The construction of the Terminal and projects for various other improvements at the airport were awarded to Norton Development Company, LLC for total project costs of \$96.1 million through January 2011. Both of these companies are managed by Scot Spencer, who had limited experience in capital project airport development prior to being selected for these functions on a sole source basis.

Although SBIAA is not prohibited by law from contracting on a sole source basis for professional services, these contracts have been extremely profitable for the involved companies. As described in Section 5 of this report, efforts to broadly solicit interest in these projects from experienced companies were limited. In every instance, it appears that the contracts were awarded after direct negotiations between the Interim Executive Director and Mr. Spencer. Although each of these contracts were approved by the SBIAA Commission in accordance with the Interim Executive Director's recommendations, there was no meaningful discussion of other alternatives made by the Commission as the contracts came forward.

Other public agencies establish policies that allow sole source contracting to be used only in certain specific instances, and not only when there is a vague perception that the contract will be "advantageous" to the agency. Even if only this broad criteria had been used, we found no substantive analysis or justification for proceeding with sole source management contracts in either of these instances. The SBIAA Commission should direct management to examine practices in other public agencies and adopt more robust policies that limit sole source contracting and require substantive justification when recommendations are presented by management to proceed in this direction.

Equipment Acquisition: As discussed in Section 3, Mr. Spencer also managed a company that was awarded a \$4.1 million contract for the purchase of jet bridges and other equipment for the terminal project. Many of the same questions apply regarding sole source contracting for major equipment acquisitions, and these questions are examined more fully in Section 3 and Section 5 of this report. However, other questions became apparent as this matter was examined as part of this performance audit.

As described fully in Section 3, a listing of the equipment to be purchased was attached to the purchase agreement that was approved by the SBIAA Commission. However, the purchase agreement was never exercised by SBIAA management and, instead, the equipment was purchased using more general authority as part of the Terminal Project. Although total costs of the purchase were only slightly above the appropriation amount approved by the Board, the amount expended exceeded the \$4.1 million original purchase order estimate and required the 10% contingency approved by the Board to be used (for total costs exceeding \$4.5 million). In addition, it is not clear that SBIAA received all of the equipment management had told the Commission it would be receiving or that it was in the condition that had been described when received. No evidence could be produced by SBIAA management showing that a condition assessment of the equipment was prepared prior to the purchase, and management could not produce a comprehensive inventory that satisfactorily demonstrates that all of the purchased equipment has been or will be received. These are basic documentation requirements for any effective internal control environment. The absence of such documentation speaks to the weaknesses in SBIAA's overall internal control management systems.

Legal Settlement: As discussed in Section 4, SBIAA entered into an expedited settlement agreement with Norton Aircraft Maintenance Services, LLC (NAMS) and SBD Aircraft Services, LLC (SBD) for a claim involving dual occupancy of Hangar No. 695. The hangar had already been leased to Aeros Aeronautical Systems Corporation, which was occupying the hangar on a day to day basis pursuant to a lease agreement previously executed with the airport.

Although Section 4 examines this incident and the resulting settlement of nearly \$1 million in detail, there are aspects of the circumstances that speak to the lack of formalized policies and procedures, and the need to fully document critical business processes.

During the period when a short term lease was being negotiated with Aeros, the Director of Economic Development and Marketing had been in communication with the Assistant Director regarding the proposed terms of the lease and other related matters. In an email from the SBIAA Assistant Director prior to the execution of the lease with Aeros, the Director of Economic Development and Marketing was instructed that the lease “needs to be a revocable license,” which would allow SBIAA to evict the tenant, Aeros, with a short notice of 24-hours. Instead, the document executed with Aeros was a standard lease that required SBIAA to give Aeros 30-days notice before eviction.

Because the Assistant Director asserts that he did not know that his instructions were not followed, he separately entered into a standard lease agreement with NAMS for a period of six months that created an overlap period for the two leases. This served as the basis for the claim by NAMS and SBD that resulted in the \$1 million settlement agreement.

An examination of documentation provided by SBIAA indicates that there are no policies or procedures related to the short- or long-term leasing of facilities at the airport, or any formalized documentation that defines the circumstances when the use of revocable license agreements would be preferred over a standard lease. Further, the two lease agreements were executed separately by two different managers in the SBIAA organization, suggesting that approval processes were not centralized. The lack of communication between the two managers clearly led to the misunderstanding and the costly consequences of the claim settlement.

After the errors were made known and the claim was submitted to SBIAA, a memorandum from the Assistant Director was circulated to management staff that stated, “Effective immediately, all contracts, leases, and other agreements involving the IVDA and/or SBIAA with outside parties should be prepared for execution by either Don Rogers or myself.” There is no evidence that more specific policies and procedures or documentation of business processes are being considered or developed at this time.

Authority of the Governing Boards Has Been Diluted

The IVDA and SBIAA boards⁷ have delegated considerable authority to the Interim Executive Director and the bodies’ oversight of the airport could be strengthened. Based on interviews and a review of a sample of public meetings, discussions of matters with significant impact on the organization are often brief, with each body meeting less than one hour on average. The boards generally support staff recommendations and, according to the Interim Executive Director, make “near unanimous decisions” on virtually all matters.

In interviews, management staff stated that preparatory briefings are conducted with the co-chairs and, depending on interest, one other board member on a routine basis. There are no

⁷ The governing board of SBIAA is technically a commission.

standing committees, except the “Finance and Budget Committee,” which meets quarterly and seasonally, and only considers matters referred to it by the full Board. There is no audit committee or other standing committee for either body that routinely examines the organizations’ financial statements or focuses on financial matters, which is central to the GFOA’s best practice standards for sound financial management.

A review of staff reports indicates that explanations are often vague and critical information changes without a full written explanation. For example, staff reports submitted to the SBIAA Commission for the contract to construct the FBO facility began with a project cost estimate of \$5.0 million (3/14/2007 Item 10) and rose to \$9.0 million within four months (7/18/2007 Item 7). Over time, the scope of services with the contractor, SBD Properties, LLC, was expanded to include the buyout of leaseholder interest from Blue’s Aviation, the renovation of Building No. 674, the acquisition of equipment and furnishings, and the renovation of the airport fuel farm. While the financial transactions were generally described in a series of staff reports to the Commission, the auditors were not provided with documents that clearly or succinctly displayed the project amendments, the budget and actual costs for each component of the project, or full descriptions of the purpose, scope and justification for added improvements.

In addition, the combined IVDA and SBIAA organization has aggressively changed its approach to staffing in the past several years. The organization has no civil service staff positions and fulfills all major functions through contracts with third party companies (i.e., the Interim Executive Director and the Aviation Director, through third party companies they formed for the purpose; Agency Counsel, through an established law firm; and personnel hired under the San Bernardino Police Department and San Bernardino Airport Management) or at-will employment contracts with individuals. Although contracting is not necessarily inappropriate, the extent to which it is used at IVDA and SBIAA is unusual for a publically owned enterprise. According to some individuals interviewed for this audit, in part, the extensive contracting and delegation of authority has occurred to circumvent certain civil service and internal control processes that would otherwise be required if the organizations were operated by public employees. In addition, these changes clearly centralize authority and control under the Interim Executive Director, who now has authority to unilaterally make significant decisions and terminate employees, who have sacrificed civil service protections with the change in status to at-will employee contractors.

Accounting Services

IVDA and SBIAA have retained the services of Rogers, Anderson, Malody & Scott, LLP (RAMS), based in San Bernardino, to audit the financial statements of the two organizations and conduct certain performance reviews. Don Rogers, the Interim Executive Director of the two organizations, was a founding partner in the firm and an active manager prior to his retirement.

In 2002, the federal government passed the Sarbanes-Oxley Act (SOX), which examined several matters related to ensuring auditor independence in the wake of the Enron scandal. Although SOX applied principally to publically traded companies that are registered with the Securities and Exchange Commission (SEC), many public agencies incorporated some of the key provisions of the legislation in an attempt to increase transparency and ensure auditor independence. Notably, several jurisdictions decided to rotate financial auditing firms every five

years as a best practice. Although the Government Finance Officers Association (GFOA) recommends that audit firms be retained for a minimum of five years, it also recommends that the auditing firm be selected using a competitive process.⁸

The Interim Executive Director states that he has no financial interest in RAMS, despite being a founding partner of the firm. Nonetheless, there could be the appearance of a conflict of interest. Specifically, *Government Auditing Standards (GAS)*, Chapter 3, Section 3.02 states,

In all matters related to the audit work, the audit organization and the individual auditor, whether government or public, must be free from personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence. (Emphasis added).

This performance audit did not include a detailed review of the audits or compliance reviews performed by RAMS, and therefore did not identify any actual conflict. However, given that the firm has already performed audit services for at least five years, IVDA and SBIAA should (1) adopt a policy to rotate financial auditing firms every five years and (2) solicit proposals from alternative qualified firms through a formal Request for Proposal (RFP), competitive process for the next five year audit cycle. Firms that bid on the project should be required to declare any actual or perceived conflicts of interest as part of the proposal submission process.

Conclusions

The San Bernardino International Airport Authority has not established effective internal controls over financial management activities. The internal control foundation is weak, policies and procedures are neither current nor effective and business processes are poorly documented. The Commission should direct management to strengthen this internal control foundation over the next 12 months by establishing appropriate policies, procedures and business processes that protect the Authority's assets.

Although most major financial matters are brought before the Commission for consideration, the analysis supporting decision-making is often incomplete or vaguely stated. Authority for approving individual financial and contract transactions has been delegated to mid-level managers within the organization. In critical areas, the Authority's Chief Financial Officer has limited involvement in the initial review and approval of such transactions.

The Authority has secured the services of a local accounting firm to conduct its annual audit and various special compliance reviews. In some instances, the scope definitions for these reviews have been narrowed by management to exclude major areas of exposure. In addition, although we found no evidence of impropriety, the Interim Executive Director was a founding partner of the accounting firm with which the Authority contracts. The Commission should adopt a policy requiring rotation of auditing firms every five years and solicit the services of other accounting firms through a competitive bid process to remove any appearance of an impairment to auditor independence.

⁸ Government Finance officers Association, *Best Practice Audit Procurement (1996 and 2002)*

Recommendations

The SBIAA Commission should:

- 1.1 Direct management to develop comprehensive policies and procedures within 12-months of the receipt of this report.
- 1.2 Direct management to refine processes for ensuring the comprehensive documentation of business processes and transactions.
- 1.3 Convene a workshop to evaluate approaches to improving the quality and understandability of management reports to the governing board.
- 1.4 Adopt a policy to rotate financial auditing firms every five years.
- 1.5 Solicit proposals from qualified auditing firms to provide financial audit services for the next five year audit cycle.

Costs and Benefits

There would be no cost to implement these recommendations.

The SBIAA internal control environment would be strengthened. Documentation of internal control business processes and financial transactions would be improved. The SBIAA Commission would be provided with better information upon which to base their decisions.

The appearance of impaired auditor independence would be reduced.

2. Construction Management

- SBIAA management proceeded with the Terminal Development and Fixed Based Operation (FBO) projects in a manner contrary to industry standards for large public infrastructure projects. Specifically, SBIAA management did not (1) conduct competitive bidding for general contractor services; (2) adhere to a clearly stated compensation structure for development contractors; (3) base the Terminal Building design substantially on transparent and methodical analysis of anticipated passenger traffic; (4) report a clearly defined budget to the SBIAA Commission throughout the project; or, (5) utilize clear and effective policies and procedures.
- SBIAA management made alterations to the timelines and scale of the Terminal Development Project based on more aggressive passenger traffic projections and assertions of prospective air carrier requirements provided by the contractor with whom management intended to hire as the project developer through a sole source contract. This created a clear conflict of interest, since the developer has been paid on a percentage-of-project-cost basis and any increases in project cost leads directly to increased compensation for the developer. Further, the updated projection of passenger demand is highly questionable, since the bases for the projections are unclear and unsubstantiated. Project design decisions advocated by the developer led to changes in schematic design and significantly higher costs, including: (a) \$9 million for a two-story concourse, (b) over \$4 million for major aviation equipment, and (c) \$2.7 million to fast-track the project. Similarly, SBIAA management allowed the same development contractor to define the FBO project design and scale, leading to substantially higher costs.
- The scope and cost of the Terminal Development Project grew incrementally from approximately \$22 million based on an initial design in January 2006, to \$38 million based on a revised conceptual design in May 2007, to over \$100 million budgeted as of January 2011 with work and costs continuing to be incurred. Likewise, the scope and cost of the FBO Project grew incrementally from a reported \$5 million in March 2007 to over \$33 million as of January 2011. The combined compensation paid to date to developer affiliated companies has amounted to \$7.4 million as of January 2011.
- SBIAA has managed the Terminal Development and FBO projects with insufficient controls. These control weaknesses have included: (1) the absence of sufficient policies and procedures; (2) the lack of an independent audit for either project; (3) poorly written leases that provide for little contractor oversight; and, (4) an opaquely written and implemented compensation structure for the two development companies. The fund control process set up for the Terminal Development and FBO projects has not prevented waste of taxpayer funds. The fund control process (1) alienates the Chief Financial Officer from day to day financial oversight of major construction projects and (2) results in poor budgetary controls.

Due to resource and time constraints, the audit team focused the scope of the construction management review on the Terminal Development Project because of its relative size and risk to the Authority. However, a limited scope review of the Fixed Based Operations (FBO) Project was conducted and the findings from that review are included in this section.

SBIAA Management Has Disregarded Standard Practices

San Bernardino International Airport Authority (SBIAA) management circumvented many standard project management processes for the Terminal Development Project and the (FBO) Project. Generally, public infrastructure projects are structured with certain controls and processes in an effort to ensure that the project is designed appropriately, stays within the allotted budget, is completed on schedule, and that project funds are not used inappropriately. Further, SBIAA has had established processes used by experienced in-house development staff for capital projects from the design phase to construction and project completion. However, these processes were not followed for the Terminal Development and FBO projects. Rather, SBIAA management set up a separate process that was largely managed by outside contractors and had limited involvement from SBIAA staff.

Some precautions that public agencies use for major capital projects include the following:

- Public agencies tend to favor using a competitive process for awarding major development contracts. Competitive methods are generally used for construction contractors as well as the acquisition of materials, supplies, and equipment on large public infrastructure projects. While local public agencies in California are not required by law to use a competitive process for professional services, such as architectural services, many agencies, including the County of San Bernardino, will do so based on internal policies and require reasonable, written justification for exceptions.
- When drafting and executing contracts, prudent public agencies make sure to clearly structure the compensation arrangement in the contract and, when necessary, transparently report the compensation arrangement to the pertinent legislative or oversight body before approval of such contracts.
- Public agencies generally proceed with capital and construction projects based on a methodical process that includes design specifications, which are produced by architects with demonstrated competence and professional qualifications. Further, design specifications for major public buildings are largely based on transparent, comprehensive, and sound analysis of the forecasted needs for the project.
- Senior officials of public agencies are generally required to clearly state the proposed budget for major infrastructure projects to the relevant governing body. Further, public agency management officials are also required to regularly report to the relevant oversight body on the agency's ability to complete the project within that budget.

- Prudent public agencies utilize clear and effective controls, policies, and procedures to ensure that (1) project funds are only used for the designated project; (2) capital projects are undertaken and completed within the allotted budget; (3) the project stays within scope or that changes to scope have been made consistent with an established process; (4) executive leadership, citizens and the media are well informed of project progress; and, (5) capital projects are completed on schedule.

SBIAA management generally did not follow these practices when implementing the Terminal Development Project and the FBO Project. Specifically:

- SBIAA management awarded development contracts to Norton Development Company, LLC (Norton Development) and SBD Properties, LLC (SBD Properties), both managed by the same individual, Scot Spencer, on a non-competitive basis. Also, SBIAA management did not provide the Commission with justification of why it was not using a competitive method for selecting the two contractors. Further, only one, unjustified, argument was given for why the construction management and development functions were to be contracted out rather than managed by experienced in-house staff.
- SBIAA management did not ensure that the compensation arrangements in the Terminal Development Lease and the FBO Lease were clear. Further, SBIAA management did not clearly report to the Commission on the structure and approximate level of compensation to be provided to Norton Development and SBD Properties.
- SBIAA management altered the initial plans and specifications for the Terminal Building renovations based on assertions of air carrier interest, assertions of these air carriers' requirements to provide service, and aggressive projections of passenger traffic provided by Scot Spencer, the eventual developer of the building. These projections do not appear to be based on sound analysis. Further, these changes led to about \$30 million in additional project costs. The changes also led to the purchase of over \$4 million in used major aviation equipment, in a deal arranged by Mr. Spencer.
- SBIAA management did not fully represent the proposed budget to the Commission when it was considering a resolution to approve the Terminal Lease between SBIAA and Norton Development. Further, SBIAA management did not regularly apprise the Commission of the Authority's inability to complete the project within budget.
- SBIAA management failed to set up and maintain appropriate and effective controls, policies, and procedures for the Terminal Development and the FBO projects. Specifically, SBIAA has *not* (1) put in place a policy on professional services contracts; (2) consistently followed its purchasing policy for the acquisition of materials, supplies, and equipment for the Terminal Development and FBO projects; (3) conducted comprehensive audits of the Terminal Development and FBO projects even as project costs rose dramatically; (4) adhered to compensation and reimbursable cost structures as stated in the leases; (5) set up effective fund controls; or, (6) transparently monitored and reported on project status and activities.

The failure of SBIAA management to adhere to standard and prudent practices has been detrimental to the Authority and to the Inland Valley Development Agency (IVDA). The consequences of these actions have included: (1) a substantially higher cost and scope of work than originally authorized or anticipated; (2) a terminal building constructed for passenger traffic that has not materialized and is unlikely to occur in the foreseeable future; and (3) questionable and, in some cases, highly inappropriate contractor expenses under the Terminal Development and FBO projects.

Timelines, Scale, and Design of Terminal Development Heavily Influenced by Developer

The Manager of Norton Development, which SBIAA non-competitively awarded the Terminal Development agreement, significantly influenced the timelines, design, and construction of the terminal building. SBIAA management set aggressive project timelines based on assertions by the Manager of Norton Development of imminent major air carrier service that has not materialized. Moreover, the design of the terminal building was altered from its initial design to service significantly more passenger traffic based on projections provided by the Manager of Norton Development. Further, the scope and cost of the Terminal Development project grew substantially after Norton Development was awarded a sole source lease for development of the Terminal building.

SBIAA Management Expedited Project Timelines Based on Expectation of Imminent Major Air Carrier Service

SBIAA management proceeded swiftly with the construction of the Terminal Development Project, resulting in at least \$2.7 million in additional costs. The decision to proceed quickly was based on an expectation that major air carrier service was imminent. This expectation was based on assertions made by Mr. Spencer, the Manager of Norton Development, which was awarded a sole source lease to develop and manage construction for the terminal building in May 2007.

Toward the end of the planning and design stage of the Terminal Project, in the fall of 2006, SBIAA management had planned to open the terminal to scheduled air passenger service within approximately 18 months. According to terminal planning meeting minutes from November 2006, SBIAA management set this timeframe in response to the Manager of Norton Development's assertions that two air carriers were on the verge of signing agreements to imminently begin providing commercial air passenger service at the San Bernardino International Airport (SBIA).

According to minutes from the November 28, 2006 terminal planning meeting, the Manager of Norton Development stated to SBIAA management and the architectural and engineering consultants that "one of the air carriers may sign an agreement as early as January [2007] and the other shortly thereafter, in March [2007]." By late December of 2006, according to planning meeting minutes, SBIAA management had set a target date of June 2008 for completion of construction and permitting.

In late May 2007, when the SBIAA Assistant Director and the Manager of Norton Development signed and executed the Terminal Lease, SBIAA management was still expecting an imminent commitment from at least one major air carrier. The Schedule of Performance under the Terminal Lease between SBIAA and Norton Development states that passenger air carrier operations at the remodeled terminal would commence within 390 days of the Lease Agreement effective date. Given that the Terminal Lease effective date was May 29, 2007, SBIAA anticipated commencing air carrier operations by June 22, 2008. Moreover, the Schedule of Performance under the lease states that a signed letter of commitment from a passenger air carrier would be obtained within 60 days of the effective date (by July 28, 2007). The lease further states that a signed letter of commitment from an air carrier was “Expected to occur by June 15, 2007.” To date, nearly three years after the expected commencement of operations, no air carrier has agreed to provide scheduled passenger service at SBIA; and, as recently as March 2011, auditors had been advised that such contracts would be in place within six weeks. The Interim Executive Director stated that he had been advised by the contractor that such contracts would certainly “be in place before the Grand Jury issues its report.”

The construction phase of the Terminal Project was fast tracked to meet the air carrier service commitments being portrayed as imminent, resulting in higher costs and risk to SBIAA. The final terminal schematic design cost estimate, dated April 24, 2007, included a ten percent premium for “Fast Track” timelines. This fast track premium was estimated to cost SBIAA approximately \$2.7 million and was put in place to account for higher costs associated with the expedited construction phase. According to contractors who worked on the Terminal Development Project, costs associated with an expedited construction phase could include higher labor costs, such as having to hire additional prime contractors and certain materials and supplies that are more expensive when needed immediately.

Terminal Design Altered by Developer’s Aggressive Passenger Projections and Assertions of Prospective Air Carrier Requirements

SBIAA contracted with an architectural and engineering firm in September 2005 for a space-needs analysis, conceptual design, and cost estimate for the terminal building. This work, completed in late 2005, resulted in a cost estimate of about \$22 million based on data and projections contained in the airport’s Master Plan.

In July 2006, SBIAA management contracted with the same firm to conduct a second space needs study and a revised conceptual design. On this second contract, SBIAA management directed the architectural and engineering firm to alter the assumptions and parameters for the design of the terminal building based on air passenger projections and prospective air carrier demands provided by the soon to be Manager of Norton Development.¹ These changes became the basis for two terminal designs in late 2006 and early 2007. The first of these designs, completed in December 2006 and based on the altered projections, had a cost estimate of about \$104 million. In early 2007, at the direction of SBIAA management and in consultation with Mr.

¹ At this point in the project, Norton Development Company, LLC had not yet been established by Scot Spencer.

Scot Spencer,² the architecture and engineering contractor reduced this cost estimate to about \$51 million based on a second design. This final design and cost estimate still included alterations from the first conceptual design, which were based on the developer's assertions. In May 2007 the Interim Executive Director asserted to the Commission that the total cost of the project would be about \$38 million. The Interim Executive Director made this assertion in a staff report, which recommended approval of the terminal lease and acquisition agreement with Norton Development.

Initial SBIA Terminal Space-Needs Study and Conceptual Design Based on SBIA Master Plan

The initial space-needs study, completed by SBIAA's architectural and engineering contractor³ in January 2006, was based on data contained in the SBIA Master Plan. This study resulted in a conceptual design for the terminal that was estimated to cost approximately \$22 million. The purpose of the space-needs study was to determine the adequacy of the existing facilities to meet current activity and to determine what building alterations would be necessary to meet forecasted activity. The overall conclusion of the study recommended that SBIAA consider renovation of the existing terminal to support activity forecasted to at least five years of operations. This was recommended by the architectural and engineering contractor because, in their view, a brand new terminal would take a number of years to design and construct.

The contractors used the SBIA Master Plan to estimate terminal facility requirements including gate demands, baggage loading, concessions, public space, and other areas. The SBIA Master Plan contains calculated passenger volumes based on activity data from (1) former metro area Air Force bases that were converted to commercial airports; (2) airports of similar size; and, (3) air traffic in the Los Angeles Basin. The Space Needs Study used schedule patterns from Santa Barbara, as historical airline schedule information was not available from the SBIA Master Plan.

Table 2.1 on the next page summarizes the passenger activity forecast used in the Terminal Space Needs Study, which was based on the SBIA Master Plan.

² All of the evidence that we have been able to collect suggests that the architecture and engineering contractor conducted all of the necessary analysis to reduce the scope and cost of the design while sticking to the demands that Mr. Spencer represented as those of the prospective air carriers. It appears that Mr. Spencer simply approved or disapproved cost reduction options provided to him by the contractor. Although Mr. Spencer and SBIAA management have asserted that Mr. Spencer had a more active and analytical role in the reduction of costs, these assertions have no documented support.

³ GKK Works, Inc.

Table 2.1

Passenger Activity Forecasted from SBIA Master Plan

Passengers	Phase 1 (2008)	Phase 2 (2013)	Phase 3 (2023)
Annual Enplanements	198,000	460,000	1,253,000
Peak Month Enplanements	18,600	43,200	117,800
Peak Hour Passengers (Enplaned and Deplaned)	168	390	1,064

Source: SBIA Terminal Space Needs Study (January 2006)

The SBIA Space Needs Study found that the projected activity, as based on the SBIA Master Plan, did not warrant the use of jet bridges. Rather, the study found that aircrafts could be boarded with air stairs, commute-a-walks,⁴ and lift ramps from ground level using the existing building structure. The study reviewed and forecasted the need for aircraft gates and departure lounges based on the SBIA Master Plan passenger fleet mix forecast. This forecast, as summarized in Table 2.2 on the next page, projected that initial SBIA traffic would consist of an equal mix of turboprop and regional jets. The study projected a fleet primarily consisting of regional jets with some limited use of narrow body aircraft by Phase 3 (in approximately 2023 or after 15 years of air carrier service).

The Space Needs Study used these projections to conclude that the terminal would need five gates for Phase 1 (in approximately 2008), seven gates for Phase 2 (in approximately 2013), and 15 gates for Phase 3 (in approximately 2023). The study estimated the square footage of departure lounges needed for each phase of terminal operations to be 3,200 sq ft in Phase 1; 4,480 sq ft in Phase 2; and 12,640 sq ft in Phase 3.

SBIAA management established in the Space Needs Study that the level of service that the terminal would support would be at a Level of Service "C" per International Air Transport Association (IATA) standards. Table 2.3, shown on page 2-9, lists the IATA ratings for terminal congestion standards.

Discussions with the initial project architects indicate that a Level C rating is equivalent to service levels presently provided by Burbank Airport and others of a similar character. As the design capacity of airports increases, so do passenger services and amenities. A Level A airport would be equivalent to the International Terminal at Los Angeles International Airport.

⁴ Commute-a-walks are retractable passenger walkways that can be placed on airport tarmacs and provide some cover from the elements. Although the walkway is "fixed" in design, the sections are still mobile and can be instantly unpinned and reconfigured should the operation change. The sections are on wheels and can be moved without any motorized equipment.

Table 2.2**Passenger Fleet Mix Forecasted from SBIA Master Plan**

Aircraft	Aircraft Type	Average Seats Per Aircraft	Percent of Total Aircraft Departures		
			2008	2013	2023
Embraer 120	Turboprop	30	35%	-	-
Saab 340	Turboprop	34	15%	-	-
Canadair CRJ 200	Regional Jet	50	25%	30%	15%
Embraer ERJ 145	Regional Jet	50	25%	30%	30%
Canadair CRJ 700	Regional Jet	70	-	20%	20%
Embraer ERJ 170	Regional Jet	70	-	20%	20%
Canadair CRJ 900	Regional Jet	90	-	-	10%
Embraer ERJ 195	Regional Jet	106	-	-	10%
Boeing 737-700	Narrow-Body Jet	137	-	-	5%
Airbus 320	Narrow-Body Jet	150	-	-	5%
Total			100%	100%	100%

Source: SBIA Terminal Space Needs Study (January 2006)

SBIA Terminal Design Significantly Altered by Projections and Prospective Air Carrier Requirements Provided by Scot Spencer

Prior to the formation of Norton Development for purposes of constructing the terminal, the individual instrumental in the company's formation and its eventual Manager (Scot Spencer) provided flight schedule and enplanements data that sharply altered the SBIA terminal conceptual design in the fall of 2006, a few months after the terminal Space Needs Study was completed. This data was represented to the architectural and engineering contractors and subsequently in the SBIA Schematic Design Report, completed in April 2007, as the airline schedule information of "the intended air carriers." While the basis and origins of this data were not transparent or verifiable, SBIAA management directed the architectural and engineering contractor to use it to alter important conclusions and recommendations for the terminal design. These changes included alterations to assumptions and parameters, which were the basis for calculations used to develop the conceptual designs for the passenger terminal, airport signage, airport monument, and terminal short term parking area. Additionally, the IATA standard for terminal congestion was altered from a previously approved "C" level of service to a "B" level of service based on Mr. Spencer's assertion of prospective air carrier requirements.

Table 2.3

IATA Terminal Congestion Standard Ratings

Rating	Rating Description
A	Excellent level of service; condition of free flow; excellent level of comfort.
B	High level of service; condition of stable flow; very few delays; high level of comfort.
C	Good level of service; condition of stable flow; acceptable delays; good level of comfort.
D	Adequate level of service; condition of unstable flow; acceptable delays; inadequate.
E	Inadequate level of service; condition of unstable flow; unacceptable delays; inadequate level of comfort.
F	Unacceptable level of service; condition of cross-flows, system breakdown and unacceptable delays; unacceptable level of comfort.

Source: SBIA Terminal Conceptual Design, Appendix B (December 2006)

The data provided by Mr. Spencer projected significantly higher passenger figures on a considerably faster timetable. While the SBIA Master Plan projected 460,000 annual enplanements within five years of initial operations (approximately by 2013), the data supplied by Mr. Spencer projected 945,498 annual enplanements within two years of initial operations (approximately by 2009). Table 2.4 below summarizes the passenger activity forecast used in the SBIA Terminal Schematic Design, which was based on flight schedule and enplanements data provided by Mr. Spencer and used for the final design and construction of the terminal building.

Table 2.4

Passenger Activity Forecasted from Developer's Data

Passengers	Phase 1 (2007)	Phase 2 (2008)	Phase 3 (2009)
Annual Enplanements	108,129	552,954	945,498
Peak Month Enplanements	26,588	64,558	97,425
Peak Hour Passengers (Enplaned and Deplaned)	858	2,082	3,143

Source: SBIA Terminal Schematic Design Report (April 2007)

The Schematic Design was based on an altered projection of serviced fleet. Specifically, the design assumptions were revised from an initial fleet mix consisting of 50 percent turboprop aircraft (seating 30 to 34 passengers) and 50 percent regional jets (seating 50 passengers) to an initial fleet mix consisting of 50 percent regional jets (seating up to an average of 106 passengers) and 50 percent narrow body jets (seating up to an average of 150 passengers). The

Schematic Design Report also newly assumed that the regional jet operations would eventually be replaced with main line jet aircraft.

The developer's revised passenger projections and assertions of prospective air carrier demands led to the construction of an expensive two-story concourse as well as the purchase of several jet bridges (see Section 3). Mr. Spencer asserted that prospective air carriers he was negotiating with refused to provide service to SBIA unless the airport had jet bridges. The requirement that only jet bridges be used for boarding aircraft led to the need for the new two story concourse, which was estimated in April 2007 to cost approximately \$9 million in additional funds to construct.

Previously, the January 2006 SBIA Space Needs Study concluded that, based on the projected fleet mix, all aircraft would be boarded from ground level using air-stairs and lift ramps when necessary. The December 2006 terminal design assumptions and parameters and the April 2007 Schematic Design Report, based on the developer's projections, assumed that only jet bridges would be used to board aircraft. As detailed in Section 3 of this report, Norton Development was awarded an agreement totaling approximately \$4.2 million in July 2007 for the acquisition, transport, and refurbishment of used major aviation equipment, including 12 jet bridges.

The Terminal Schematic Design Report also forecasted a higher gate demand based on the updated projections. The Terminal Schematic Design recommended three gates for initial operations, six gates after one year of operations (Phase 2), and nine gates after two years of operations (Phase 3). Table 2.5 below contrasts the projected passenger activity and gate requirements of the Space Needs Study from January 2006 versus the Terminal Schematic Design Report from April 2007.

Table 2.5

SBIA Passenger and Gate Requirement Projections

Phase (Base Year)	Annual Enplanements	Operations	Enplanement Passengers/ Departure	Enplanement Passengers/ Gate	Gates
January 2006 Terminal Space-Needs Study based primarily on SBIA Master Plan					
Phase 1 (2008)	198,000	14,987	26.4	39,600	5
Phase 2 (2013)	460,000	23,508	39.1	58,653	7
Phase 3 (2023)	1,253,000	46,523	53.9	80,729	15
April 2007 SBIA Schematic Design Report based in part on Developer's Data					
Phase 1 (2007)	108,129	2,328	92.9	43,252	3
Phase 2 (2008)	552,954	10,020	110.4	94,640	6
Phase 3 (2009)	945,498	16,260	116.3	99,722	9

Source: SBIA Space Needs Study (January 2006) and Terminal Schematic Design Report (April 2007)

Norton Development Received Substantial Financial Benefit from Terminal Design Revisions

Norton Development received considerable financial benefit from the alterations made in the terminal design by its Manager, Scot Spencer. Specifically, under the Terminal Lease, Norton Development received a 1.35% developer fee on all construction costs. Therefore, as costs for the project rose, so did the compensation to Norton Development. In particular,

- According to the cost estimate provided to the Commission by the Interim Executive Director in May 2007, the total estimated cost of the Terminal Development Project was \$38 million. Given the initial conceptual design estimate of \$22 million, the revised design represented an increased cost of \$16 million. This cost increase resulted in at least \$216,000 in *additional* developer fee payments to Norton Development.
- While the Interim Executive Director asserted in May 2007 that the project cost estimate was \$38 million, the Schematic Design Estimate dated April 24, 2007 shows a total estimated cost of \$51.3 million, a difference of \$29 million from the initial conceptual design. Given this cost estimate, Norton Development stood to receive \$391,500 in *additional* developer fee payments, representing the difference between the \$22 million initial estimate and the \$51.3 million estimated in April 2007.

Terminal and FBO Project Costs and Budgets Increased Dramatically with Little Substantiation or Transparency

The scope and cost of the Terminal Development Project grew considerably from about \$22 million based on an initial design in January 2006, to \$38 million represented to the Commission in May 2007, to over \$100 million budgeted as of January 2011 with work and costs continuing to incur. Similarly, the FBO Project grew from an initial estimate of \$5 million in March 2007 to over \$30 million budgeted and expended as of January 2011, with costs continuing to incur.

Interim Executive Director Inaccurately Reported Initial Cost Estimate on Terminal Development Project to the Commission

The Interim Executive Director inaccurately reported and gave very limited details on the costs to undertake the Terminal Development Project to the Commission when it approved the Terminal Lease with Norton Development. Specifically, in a staff report dated May 23, 2007, the Interim Executive Director asserted that through a lease and buy-back arrangement, “it is expected that the purchase price to be paid [by SBIAA] in approximately one year, once completed, will be approximately \$38 million.” The Interim Executive Director refers to the figure of \$38 million three more times in the staff report with no other dollar figure presented and without a single breakdown of costs. In one such reference the staff report states that “the Architect’s current estimated cost” is \$38 million. In fact, the architecture and engineering firm had provided a cost estimate of \$51.3 million a month earlier, on April 24th, based on the schematic design. Even this estimate appears to be understated as, at the direction of SBIAA management, it excluded substantial costs such as hazardous waste abatement and remediation, construction of parking lots, and off-site construction.

While the Interim Executive Director asserted to the Commission that the Terminal Development Project would cost \$38 million, the terminal lease⁵ obligated SBIAA to purchase the property back at a higher cost, as determined by Norton Development. While the May 2007 staff report simply stated that “the final price will be based on actual costs incurred,” the terminal lease bounded SBIAA to pay the price determined by Norton Development as long as the final project costs were “equal to or less than \$45,000,000.” This amount is well above the quoted cost estimate of \$38 million as well as the customary 10 percent contingency amount (\$3.8 million), which would have totaled \$41.8 million.

Table 2.6 below details the April 24, 2007 cost estimate provided to SBIAA management by the architecture and engineering contractor. While SBIAA management used this estimate to move forward with the Terminal Development Project, no such cost breakdown was provided to the Commission prior to approval of the terminal lease.

Table 2.6

SBIA Terminal Development Project Cost Estimate as of April 2007

Cost Item	Schematic Design Cost Estimate
Terminal Building (Excludes two story Concourse)	\$11,572,400
Concourse	9,114,200
Site Improvements	4,061,000
Subtotal	24,747,600
General Conditions	1,484,856
Bonds & Insurance	524,649
Subtotal	26,757,105
Design Contingency	4,013,566
Escalation	1,605,426
Fast Track	2,675,711
Subtotal	35,051,808
Contingency	3,505,181
Total Hard Cost	38,556,988
Furniture, Fixtures, & Equipment	3,847,800
Construction Mgmt./ Design/Testing/Permitting	8,892,884
Total	\$51,297,672

Source: GKK Works SBIAA Schematic Design Estimate (April 24, 2007)

⁵ Exhibit A, Section 2.7

As previously mentioned, the \$51 million estimate provided by the architecture and engineering contractor, as illustrated by Table 2.6 above, appears to have been a purposeful understatement of the estimated costs to complete the Terminal Development Project. Specifically, SBIAA management directed the contractor to omit significant costs, including hazardous waste abatement and remediation, and parking lot and certain off-site construction; and, the estimate omitted amounts for specialized communications, security, information and surveillance systems.

Terminal Project Costs and Budget Steadily Increased During Construction

The Terminal Development Project costs and budget grew dramatically during construction from the Interim Executive Director's initial estimate of \$38 million in May 2007. As of January 2011, over \$100 million had been budgeted for the project, an increase of over 160 percent. Although a detailed breakdown of budgeted and actual costs has not been provided by SBIAA management, an IVDA staff report from December 2010 presented by the Aviation Director provides a superficial itemization of previously approved amounts. Table 2.7 on page 2-14 summarizes these budgeted amounts.

FBO Project Costs Increased Substantially From Initial Authorization

A review of the FBO Project found many similarities to the Terminal Development Project. These similarities include: (1) the lease was awarded to a company managed by Mr. Spencer without the use of a competitive process; (2) SBIAA provided vague and limited information to the Commission and IVDA Board on the project scope and costs, especially in the initial phases; (3) the developer, in this case SBD Properties, was allowed to heavily influence the scale and design of the project; (4) the lease was structured in such a way that SBIAA accepted all financial risk and the developer took on no financial risk; and, (5) the scope of the project grew incrementally, but substantially, over time.

The FBO Project has grown from an initial estimate of \$5 million in March 2007⁶ to over \$33 million budgeted as of January 2011 with costs continuing to be incurred. Further, while the Assistant Director asserted to the Commission that SBIAA staff would "maintain control over design and costs incurred," it appears that the developer had significant control over the design, scale, and costs of the project. Table 2.8 on Page 2-15 summarizes the evolution of the estimated and budgeted costs of the FBO Project.

⁶ In March 2007 the Assistant Executive Director asserted to the Commission that the FBO building would cost an estimated \$5 million to construct.

Table 2.7

Terminal Project Budgeted Amounts as of January 2011

Date	IVDA Resolution #	Purpose	Amount Budgeted
May 23, 2007	2007-01 ⁷	Terminal Funding per Lease Agreement	\$38,000,000
July 23, 2008	2008-08	Parking Lot Phase I; Acquisition & Installation of Communications, Security, Information & Surveillance Systems	19,000,000
March 11, 2009	2009-03	Parking Lot Phase II; Rental Car Lot; Renovation of Building 675 for flight kitchens & ground service equipment maintenance; Monument Signs	9,275,000
April 8, 2009	2009-06	Ramp Pavement Rehabilitation and Replacement Phase I; 10% Contingency	14,513,100
October 14, 2009	2009-15	Ramp Pavement Rehabilitation and Replacement Phase II	3,800,000
December 9, 2009	2009-19	Initial terminal equipment maintenance; relocation of impacted utilities; security enhancements; construction of cargo facility	1,900,000
May 12, 2010	2010-03	As Needed Additional Project Requirements; Changes to Security and Customer Service.	5,950,000
September 8, 2010	2010-07	Additional Ramp Rehabilitation and Replacement Costs	1,095,000
December 21, 2010	2010-12	Air Cargo Facility; Airfield Security and Communications; Ramp Improvements; Flight Kitchen; Parking Lot Costs; Additional Improvements & Equipment for Terminal Building;	7,135,769
Total			\$100,668,769

Source: IVDA Staff Report prepared by SBIAA Aviation Director (December 21, 2010)

Note that all of the amounts displayed in Table 2.7 above also included administrative and project management costs including fund control fees, project management costs, and developer fees. Norton Development has received substantial financial benefit from the increases since the original \$38 million was approved, totaling approximately \$846,000 in *additional* developer fees alone.

⁷ IVDA Resolution 2007-01 and the accompanying IVDA Resolution 2008-03, approved in February 2008, authorized a total of \$38 million for the Terminal Development Project.

Table 2.8
FBO Project Cost Estimates and
Approved Funding Amounts as of May 2010

Date	Resolution	Purpose and Comments	Amount Approved
March 14, 2007	SBIAA 2007-03	Approval of FBO Lease. Assistant Director states in staff report that estimated cost for FBO Building is \$5 million . No other costs mentioned in the staff report. Actual lease obligates SBIAA up to \$9 million.	None
June 13, 2007	SBIAA 2007-04	FBO public improvements. No details or breakdowns provided on cost items.	\$7,000,000
September 26, 2007	SBIAA 2007-08	To assist in the funding of construction for the Airport Fuel Farm.	2,000,000
September 26, 2007	SBIAA 2007-09	Approval of Amendment 1 of the FBO Lease Agreement. One of the major modifications is the use of \$2,300,000 by SBD Properties for the acquisition of Don Blue Aviation Facilities' leasehold interest.	2,300,000
May 28, 2008	SBIAA 2008-04	Common use improvements including roadway, taxi lane, and utility infrastructure extensions. SBIAA is responsible for costs under FBO Lease.	3,500,000
Unknown	Unknown	As part of the annual budget process, IVDA budgeted an additional \$16,000,000 for fiscal year 2008-09 for the FBO Project.	16,000,000
August 13, 2008	SBIAA 2008-10	Approval of Amendment 2 of the FBO Lease Agreement. Amendment 2 contained major changes to the scope and cost of the FBO Project. Major changes (later codified in Amendment 2) included: (1) transfer of offices from Building 674 (the "washrack") to the FBO Building; (2) "significant enhancement" to the level of service at the FBO building; (3) two-story building to house U.S. Customs operations and additional corporate office space (no square footage provided); (4) additional FBO equipment; and, (5) the acquisition of three fuel trucks. Amendment 2 was restated and reapproved on January 28, 2009.	Unknown
December 10, 2008	SBIAA 2008-13	Acquisition of three fuel trucks.	1,000,000
January 28, 2009	SBIAA 2009-03	Approval of Restated Amendment 2. Size of Customs facilities increased to three-story, 35,288 square foot structure to accommodate potential use by larger international aircraft.	2,000,000
Total			\$33,800,000

Source: Timeline provided by SBIAA/IVDA Clerk of the Board and SBIAA and IVDA Staff Reports

As seen in Table 2.8 on the previous page, there were several increases in the scope and cost of the FBO project following the initial lease approval in March 2007. Moreover, the costs as represented to the Commission by the Assistant Director were \$5.0 million. However, the actual lease executed with SBD Properties obligated SBIAA to finance the FBO improvements up to a cost of \$9.0 million.

The scope of the improvements covered under the lease changed substantially three times between March 2007 and May 2010. The first lease amendment, approved by the Commission in September 2007, included the use of \$2.3 million in FBO funding for the acquisition of the former FBO Operator's⁸ leasehold interest.

Amendment 2, approved by the Commission on August 13, 2008, included several major changes to the design and scope of the FBO Project. These changes included:

1. The construction of a major two-story U.S. Customs facility, which was designed and approved by Million Air San Bernardino, LLC, a company managed by Mr. Spencer.
2. Significant enhancements to the level of service to be provided at the FBO Building. While the specific changes as to the level of service were not detailed in the staff report to the Commission, it appears that this is when it was determined that the FBO would provide an executive level of services.
3. The determination that the office areas originally proposed to be constructed inside Building 674 (the "washrack") would instead be incorporated as part of a larger FBO Building. This alteration moved the office construction from a project that was supported by U.S. Department of Commerce Economic Development Administration grant funds to a project that was entirely supported by SBIAA/IVDA funding.
4. The acquisition of additional equipment to "properly equip the FBO for providing a high level of service to the general aviation community." According to the staff report, the cost of the equipment was estimated at \$135,174. As listed in Exhibit A to Amendment 2 of the FBO lease, the equipment included (a) three aircraft tugs; (b) three ground power units; (c) two service carts; and, (d) four tow bars.
5. The acquisition of new general aviation fuel trucks to supplement the older equipment acquired through the purchase of the remaining leaseholder interest and assets of the former FBO, Blue's Aviation Service. The staff report states that the three fuel trucks are estimated to cost a total of \$515,000. However, another staff report presented on August 13, 2008 asked the Commission to "approve solicitation of bids and the purchase of Fuel Trucks from the lowest responsible bidder in an amount *not to exceed \$1,200,000* to support Commercial Aviation Service; and authorize the Interim Executive Director or his designee to execute all necessary documents." (emphasis added) In December 2008 the Commission approved the use of up to \$1,000,000 for the purchase of the three fuel

⁸ Blue's Aviation

trucks. While the cost of the trucks was later reduced to \$490,000 in January 2009, it is unclear if the authorized FBO funding was reduced to reflect the lower actual cost.

Five months after the Commission approved Amendment 2 to the FBO Lease, it approved a “restated” Amendment 2. This “restated” Amendment 2, approved on January 28, 2009, represented the third major change of scope for the FBO Project. The scope changes primarily consisted of an increase in the size of the Customs Facility from a two-story building to a three-story building. According to the staff report prepared by the Aviation Director, the purpose of the Customs Facility expansion was to “facilitate potential use by larger international aircraft.”

Terminal and FBO Projects Managed With Insufficient Controls

SBIAA did not establish effective policies, procedures, and controls for the Terminal Development and FBO projects given the level of financial risk that the Authority had taken on. The purchasing policies have been inadequate and have, by and large, been ignored by SBIAA for the purposes of these two projects. Also, there have been no truly independent audits of the Terminal Development or FBO projects. In addition, the controls set up in the Terminal Lease Agreement have not been enforced by SBIAA management. Moreover, the independent fund control process frequently referred to by SBIAA management and the developer as a laborious and detailed check is inadequate to prevent waste or abuse of taxpayer funds.

The failure to establish effective controls for the Terminal Development and FBO projects has resulted in, at the very least, inappropriate expenses from SBIAA funds.

Purchasing Policies Inadequate for Terminal and FBO Projects

The purchasing policy for IVDA and SBIAA, entitled *Purchasing Policies and Change Order Procedures* is inadequate for general procurement and specifically for the use of contractual services. The Purchasing Policy is outdated, lacks evidence of Board or Commission approval, appears unfinished, and lacks sufficient controls for professional services agreements. Specifically, the SBIAA/IVDA Purchasing Policy lacks provisions that directly address service contracts and provides no requirement to justify the use of non-competitive methods for selecting outside contractors.

No SBIAA Policy Directly Addresses Contractual Services or Non-Competitive Selection

There is no section in the SBIAA and IVDA Purchasing Policy that directly addresses contractual services or the use of non-competitive methods for major contracts. Although there is language in the *Open Market - Competitive Bids Required* section suggesting that a formal competitive process *may* be required for service contracts above \$25,000, there is no requirement under the policy to do so. In contrast, the County of San Bernardino Administrative Code and the County’s Policy Manual include specific procedures for selecting outside service providers and for the use of non-competitive methods for awarding service contracts.

Unlike the SBIAA/IVDA Purchasing Policy, the County's Administrative Code includes specific provisions for awarding contracts for services. The County Administrative Code⁹ requires a competitive process for all service contracts. Further, the Code requires a formal request for proposal (RFP) process for service contracts above \$150,000. The Code additionally requires approval from the County Administrative Officer prior to issuing the RFP. The County Administrative Code¹⁰ allows for non-competitive awarding of service contracts where the annual aggregate cost exceeds \$100,000 per scope of services per vendor, but requires Board of Supervisors approval.

Contrary to the SBIAA/IVDA Purchasing Policy, the County of San Bernardino Policy Manual contains provisions for the selection of outside service providers. Specifically, the Policy Manual¹¹ states that the "selection of outside service providers shall be conducted through a *competitive process* based upon *demonstrated competence*, and on the *professional qualifications and capabilities necessary* for the performance of services required at a fair and reasonable price to the County." (emphasis added) Further, the Policy Manual states that,

If a department maintains that it is in the best interest of the County to obtain services without a competitive process, the agency, department or Board-governed special district must provide the Purchasing Agent with detailed written evidence to support a non-competitive determination.

Further, the Policy Manual provides a list of general justifications for the use of outside service providers. These are to be included when:

- There is a need for special expertise or experience beyond the capability of County staff;
- There is a need for review of work performed by County staff to ensure that such work represents the best possible solution;
- County staff is unable to perform the needed work within the time required and the public interest requires such work to be done; or,
- Use of outside service providers is more cost-effective.

Weak Justification Provided to Commission for Contracting Construction Management and Development Services

SBIAA management only briefly addresses the Commission, in writing, as to why the Authority contracted with an outside developer rather than utilizing in-house staff for the Terminal Development and FBO projects. The only reference in the Interim Executive Director's May 23, 2007 staff report to the Commission justifying the decision states that SBIAA staff had,

⁹ County of San Bernardino Code of Ordinances, Title 1, Division 4, Chapter 1, Section 14.0115

¹⁰ County of San Bernardino Code of Ordinances, Title 1, Division 4, Chapter 1, Section 14.0109

¹¹ County of San Bernardino Policy Manual, Procurement of Services, No. 11-05

determined that the *fastest way to complete* the [Terminal Development] project was through a lease arrangement wherein a Developer will lease the building, construct the facilities and then turn the completed building back to SBIAA. (emphasis added)

The Interim Executive Director provides no specific reasoning or analysis to support the determination that leasing the building to an outside developer would be the fastest way to complete the project.

In addition, the Manager of Norton Development¹² stated to our audit team that SBIAA management felt that it would be faster and less costly to contract with his company rather than through in-house staff. When questioned as to how specifically Norton Development would be faster than in-house staff, the Manager stated that SBIAA is required to follow specific timelines for advertising public bids and for hearing and responding to bid protests when they occur. Contrary to these claims, the Terminal Lease Agreement contains detailed requirements for the awarding of subcontracts on a competitive basis. Specifically, Section 2.4 of Exhibit A specifies that Norton Development shall “obtain bona fide bids for each and every aspect of construction of the various components of the Improvements.” The Lease further states that Norton Development “shall cause the General Contractor to obtain no less than three bona fide bids for every „major subcontract.”” In addition, the Terminal Development project is not exempt from the bid protest process involving the Commission. In fact, a bid protest for one aspect of the Terminal Development Project went before the Commission in July 2010.

When questioned as to how specifically Norton Development would be more cost effective than in-house staff, the Manager replied that the bidding process would be more streamlined. Specifically, the Manager stated that Norton Development could re-bid jobs or ask that the lowest bidder to modify their bid if it wasn’t satisfactory. Contrary to these claims, there is no law or impediment preventing SBIAA in-house staff from taking such actions with bids.

Terminal and FBO Projects Non-Competitively Contracted to Companies with No Demonstrated Competence

SBIAA awarded the major contracts for the development of the Terminal Building and the FBO Facility on a sole source, non-competitive basis to Norton Development Company, LLC (Norton Development) and SBD Properties, LLC (SBD Properties) respectively. In addition, SBIAA did not conduct a competitive process for selecting the general contractor for the Terminal Development or FBO projects. While SBIAA is not required by law or by its own purchasing policy to conduct a competitive or formal bid process for these contracts, prudent risk management would dictate that a competitive process be used, or at the very least, reasonable justification would be provided for not doing so.

SBIAA management never directly addressed the Commission in writing as to why the Commissioners should award the Terminal Lease or the 25 year FBO Lease on a non-competitive basis. Neither the March 14, 2007 staff report from the Assistant Director on the

¹² Scot Spencer

approval of the FBO Development Lease nor the May 23, 2007 staff report from the Interim Executive Director on the approval of the Terminal Development Lease addresses this issue. The reports are silent as to the demonstrated competence, professional qualifications, or capabilities of Norton Development and SBD Properties. In fact, Norton Development was founded the same day as the Terminal Lease was approved by the Commission (May 23, 2007) and SBD Properties was founded less than a year before the FBO Lease was approved. It is therefore highly unlikely that these companies had demonstrated professional qualifications, competence, or development/construction management capabilities prior to being awarded the two contracts. Furthermore, the staff reports do not mention the demonstrated professional qualifications, competence or development/construction management capabilities of the Manager¹³ of these companies, who is the signor on the agreements and has been intimately involved in both projects. A review of the experience and qualifications of the Manager conducted for this audit suggest that he has never been involved in a major airport construction project until retained for that purpose by SBIAA.

SBIAA Purchasing Policy Not Followed for Procurement of Materials and Supplies

While the SBIAA Purchasing Policy is not strong, there are certain provisions for the purchase of materials and supplies, which could have provided some basic controls for the Terminal Development and FBO projects. However, SBIAA management instead circumvented normal purchasing policies by establishing an outside control fund to review and approve project expenses. Specifically, the SBIAA Purchasing Policy requires that all purchases over \$2,500 require the approval by a Department Head, the Chief Financial Officer, and the Executive Director. Further, the Purchasing Policy requires that all contracts and purchase orders of \$25,000 and greater to be signed by the Co-Chair or President of the Agency involved and approved by the Executive Director and Chief Financial Officer.

Rather than follow the procedures prescribed by the Purchasing Policy, SBIAA management set up a new process involving an outside fund control agency. As will be discussed in greater detail, this process alienated and circumvented the Chief Financial Officer and SBIAA Development staff and provided for more involvement by the developer, Chair of the Commission, Interim Executive Director, and Assistant Director, with controls being dependent on an outside third party.

No Audits Have Been Conducted of the Terminal and FBO Projects

SBIAA management has not engaged an independent certified firm to conduct an audit of the Terminal Development or FBO project. Given the weak purchasing policy and the disregard of standard procurement procedures, an independent audit could have served as a valuable tool for identifying internal control weaknesses and risk exposure, as well as recommending steps to reduce risk and/or resolve identified issues.

¹³ Scot Spencer

The one review that has been conducted¹⁴ covering costs associated with the Terminal Development Project was not an audit and its scope did not include a review of the General Contractor contract or specialized equipment contracts. As noted in the firm's report, they were "engaged to perform a *special compliance review* of the Terminal Building Construction Project" (emphasis added). The firm never refers to their report as an audit or their procedures as audit procedures. Further, the firm states in their report that they "were not engaged to, and did not conduct an audit, the objective of which would be the expression of an opinion, on the information described above" (the information referenced are the findings of the special compliance review). The report goes on to state that, "Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you."

Terminal Lease and FBO Lease Contain Ineffective Controls

The controls embedded in the Terminal and FBO leases have been ineffective for proper management oversight. As discussed below, none of the controls contained in the leases have ensured that SBIAA has had the ability to adequately monitor project costs or to prevent inappropriate compensation or reimbursements to the developer.

Developer Did Not Provide Periodic Reports as Required in the Leases

Although the Terminal and FBO Leases require the developer (Norton Development and SBD Properties respectively) to deliver a monthly status report to SBIAA, no such reports have been provided. Specifically, the Terminal Lease¹⁵ and the FBO Lease¹⁶ require Norton Development and SBD Properties respectively to deliver monthly reports on the status of the construction to SBIAA. The Lease requires that these reports include:

- Norton Development/SBD Properties' and the General Contractor's good-faith estimate of the Completion Date;
- Updated and accurate construction schedules;
- The cost of improvements; and,
- Whether construction costs are within budget.

SBIAA management, specifically the Interim Executive Director and the Assistant Director, asserted to our audit team that these requirements were not enforced because they felt SBIAA was fully informed of the project status through periodic construction management meetings. Although limited time and resources have not allowed for a thorough review of these

¹⁴ A special compliance review was completed in February 2010 by Rogers, Anderson, Malody, and Scott, LLP.

¹⁵ Exhibit A, Section 10, Item 10.1(b).

¹⁶ Exhibit A, Section 10, Item 10.1(b).

construction management meeting minutes, our understanding is that SBIAA management did not regularly attend such meetings.

Terminal and FBO Compensation Structure Opaquely Worded and Inappropriately Implemented

The compensation to be provided to Norton Development under the Terminal Lease and SBD Properties under the FBO Lease are vaguely structured, were not clearly represented to the Commission by the Interim Executive Director and the Assistant Director, and were implemented in a way that was highly favorable to the developer.

Terminal Lease Vaguely Structured Compensation to be Paid to Contractors

The Terminal Lease provides for at least two fees to be paid by SBIAA to contractors: a “developer fee” and a “construction management fee.” Although the lease reads as if these two fees would be provided to different parties, in practice both fees provided compensation to companies managed by Mr. Spencer (Norton Development and SBD Aircraft Services, LLC).

The Terminal Lease states that the developer fee is to cover “the overhead and profit” of Norton Development. The lease further states that,

the Developer Fee shall be calculated as follows: 1.35% of that portion of the Construction Costs which represent the cost of construction for labor, materials, services and supplies including those of the General Contractor and of each subcontractor.

A review of a sample of payment vouchers from the Terminal Development Project has found that 100% of the costs submitted have been subject to this developer fee. SBIAA, Norton Development, and the third party fund control agency have made no distinction between costs that are eligible for the 1.35% charge and those that are not eligible. Further, although this fee was to cover the *overhead* and profit of the developer, our review of project payment vouchers found that many expenses that could be considered overhead, such as electric utility, telephone, and cable television bills were reimbursed as direct expenses by SBIAA.

The Terminal Lease defines the construction management fee as

a fixed fee paid to the Construction Manager in such amount as shall be negotiated by the Seller, [Norton Development,] and subject to written approval by the Executive Director of the Purchaser, [SBIAA,] to pay for Construction Management.

Further, the Lease defines “Construction Manager” as “such person or firm that is selected by the Seller, [Norton Development,] as the Construction Manager.” It is apparent from our review of the Terminal Development Project expense vouchers that Norton Development chose itself and SBD Aircraft Services, LLC, companies that are both managed by Mr. Spencer, as the Construction Managers. Further, the amount paid to Norton Development for construction management was never approved by the Interim Executive Director in writing even though the lease states that the amount is “subject to written approval by the Executive Director.”

Interviews with the Interim Executive Director, Assistant Director, and Manager of Norton Development revealed conflicting accounts of the agreement that ultimately allowed for Norton Development and SBD Aircraft Services, LLC (SBD Aircraft) to receive over \$735,000 in compensation via construction management fees. The Interim Executive Director and Assistant Director stated that a verbal agreement was made between the Interim Executive Director and the Manager of Norton Development. The Interim Executive Director stated that he verbally told the Manager of Norton Development that the Manager could bill SBIAA for staff time spent on the project as long as it was documented. The Interim Executive Director further stated that he told the Manager of Norton Development that the amount billed under construction management had to be limited to \$13,000 per month and then immediately stated to our audit team that it was “maybe \$15,000 to \$20,000 [per month], all told.”

Mr. Spencer’s account of the agreement for receiving construction management fees conflicts with the account provided by the Interim Executive Director and the Assistant Director. Mr. Spencer stated to our audit team that Mr. Bob Christman, a former SBIAA Commissioner, told him that Norton Development could receive reimbursement of staff time via construction management fees. When asked if a cap was ever placed on the amount of compensation received through construction management fees, Mr. Spencer stated that there was nothing binding on the reimbursement level. Mr. Spencer also stated that SBIAA management agreed with this arrangement, but that it was never put in writing.

Compensation Under FBO Lease Similar to Terminal Lease

The compensation provided to SBD Properties under the FBO Lease is very similar to the compensation provided to Norton Development under the Terminal Lease. In particular, the FBO Lease provided for a developer fee and a construction management fee using virtually the same language as in the Terminal Lease. The Terminal Lease defined construction management fee using the exact same language and defined construction manager as “such person or firm that is selected by the Seller, [SBD Properties].” It is apparent from a review the FBO Project that SBD Properties chose itself to be the construction manager and therefore receive construction management fees. As of January 2011, SBD Properties had received approximately \$185,000 in construction management fees from FBO Project funds.

The developer fee in the FBO Lease, while defined with more restrictive language than in the Terminal Lease, was implemented in virtually the same manner. Specifically, the FBO Lease defined the developer fee as,

a fixed fee that covers the overhead and profit of the Seller. The Developer Fee [shall] be equal to two percent (2%) of that portion of the Construction Costs which represent the *Hard Costs of construction* for labor, materials and supplies of the general contractor and each subcontractor. (emphasis added)

A review of a sample of FBO payment vouchers found that SBIAA management, SBD Properties, and the third party fund control agent have made no distinction between hard costs and soft costs even though the FBO Lease states that only hard costs are eligible for calculating the two percent developer fee. SBIAA is therefore compensating SBD Properties for more than

what it is owed under the FBO Lease. When our audit team questioned the Interim Executive Director and Assistant Director as to what costs would be eligible for the two percent developer fee, both officials stated that there was no distinction between hard costs and soft costs, despite the very clear wording in the FBO Lease.

Terminal and FBO Compensation and Costs Not Clearly Reported to the Commission

SBIAA management did not clearly report the compensation amounts to be provided to Norton Development and SBD Properties under the Terminal and FBO leases to the Commission. Specifically, in the Interim Executive Director's May 23, 2007 staff report to the Commission there is only a brief and somewhat vague reference to the compensation to be paid to Norton Development under the Terminal Lease. Specifically, the staff report states that,

All costs are subject to audit verification and only direct costs, financing costs, and a *Development fee of 1.35%* are reimbursable. *There is also an incentive payment of 1.7% for any cost savings achieved.* This percentage will be applied to the difference between actual costs and the Architect's current estimated cost of \$38 million. (emphasis added)

The Interim Executive Director did not detail compensation that Norton Development or SBD Aircraft was to receive through "construction management fees." Further, the Interim Executive Director never gave an estimate of the total amount of compensation that Norton Development would receive as a result of the Terminal Lease.

In the May 23, 2007 staff report to the Commission, the Interim Executive Director makes contradictory statements on the costs borne by Norton Development. Under the *Background and Comments* Section, the report states that "Norton Development Company shall be responsible for completing all improvements, currently estimated at \$38 million, at its sole cost and expense." In fact, Norton Development Company expended almost no costs or expenses of its own for the Terminal Development Project. In the same paragraph, as in the previous statement, the Director notes that, "It is anticipated that Norton Development Company shall procure a construction loan for such work, *which may be secured by a construction loan guarantee from the Inland Valley Development Agency.*" (emphasis added) The construction loan was in fact secured by the Inland Valley Development Agency. Moreover, Norton Development and its subcontractors were reimbursed for all costs expended as the project proceeded.

SBIAA management provided an opaque presentation to the Commission on the compensation to be provided to SBD Properties under the FBO Lease. In the Assistant Director's staff report to the Commission on March 14, 2007, there is *no* mention of compensation to be provided to SBD Properties. Rather, the staff report presents the FBO Lease as a revenue generator for the airport. Moreover, the Assistant Director asserts in the staff report that "as a requirement of the lease agreement SBD [Properties] will construct a new FBO building to include executive offices, pilot lounges, and other amenities at its own expense and will provide financing thereof." In practice, the funding for the FBO building was provided by a loan guaranteed by SBIAA and IVDA. The Commission adopted Resolution 2007-03 approving the FBO lease agreement with SBD Properties on March 14, 2007.

Fund Control Process Inadequate to Prevent Waste

The fund control process set up by SBIAA management for the Terminal and FBO projects has been wholly inadequate for preventing waste of taxpayer monies. A review of a judgmental sample of Terminal and FBO fund vouchers and checks has found: (1) the Chief Financial Officer and SBIAA development staff have not been involved in the day to day approval of major expenses; (2) the Chair of the Commission has been given day to day approval authority for project expenditures; (3) project funding has been used for non-project purposes; and, (4) the fund control agency's controls and standards have not been consistently applied.

Fund Control Process Circumvented Standard Practices

In July 2007, SBIAA management executed an agreement with Orange County-based California Fund Control, Inc. (the company later changed its name to First American Fund Control) in order to control the disbursement of SBIAA/IVDA funds to Norton Development for the Terminal Development Project. A second similar agreement was also established with the same company for the disbursement of FBO Project funds. The establishment of this fund control process was a circumvention of standard practices. IVDA/SBIAA Development staff as well as the Chief Financial Officer had been responsible for the management of construction and funding on previous capital projects. Established procedures for managing internal and grant funds were not followed for the Terminal Development and FBO projects.

Neither SBIAA nor IVDA had utilized an outside fund control agent previous to these agreements. Further, the legal structure approved by SBIAA/IVDA legal counsel, had never been used by SBIAA or IVDA. Specifically, SBIAA management and legal counsel established a "lease-buy back" arrangement for the Terminal Project wherein SBIAA leases the building to the developer, which is required to make certain improvements. The lease then sets certain conditions for the purchase of the leasehold back from the developer. SBIAA management and legal counsel established a "lease-lease back" arrangement for the FBO Project, wherein the property is leased to the developer, which is required to obtain an executed agreement with a National FBO company and make certain improvements. Once the FBO building is complete, the developer is then to lease the FBO building from SBIAA for 25 years.

Chief Financial Officer Alienated from Detailed Oversight

Although public agency Chief Financial Officers (CFO) typically oversee or directly perform capital project monitoring and reporting, the SBIAA/IVDA CFO has played a very negligible role in the Terminal Development and FBO projects. Rather, senior SBIAA management (the Interim Executive Director, Assistant Director, and Aviation Director) together with select Commissioners, the developer, and the third party fund control agency, have been charged with reviewing and authorizing the bulk of the financial transactions.

Generally, public agency CFOs are tasked with various responsibilities related to capital projects to help manage the significant financial risk involved. The Government Finance Officers Association (GFOA) recommends that CFOs' responsibilities relating to capital projects include,

among others, ensuring that legal and fiduciary requirements are incorporated into capital monitoring and reporting and that the project stays within scope. Table 2.9 on the next page compares the GFOA best practices recommendations for finance officer involvement in capital project monitoring and reporting versus the SBIAA CFO's role in the Terminal Development Project.

Commission Chair's Level of Involvement in Funding Process Unusual

The Chair of the Commission has been given an active role in the approval of Terminal Development and FBO project expenses, normally reserved for staff-level positions who had substantial capital project experience and knowledge of the details of the project. Under the fund control process set up for the two projects, three signatures are required before the fund control agency can issue checks to the payees. One of these signatures must be from a representative of the developer, a second signature must be from IVDA/SBIAA (the Interim Executive Director, Assistant Director, or Chief Financial Officer), and a third signature must come from a Chair of the SBIAA Commission/IVDA Board or from the Vice-Chair of the Commission. A review of a sample of Terminal and FBO project payment vouchers has found that the Chair of the SBIAA Commission has approved the vast majority of expenses submitted. Further, there is no evidence that the Chief Financial Officer approved any of the expense vouchers for either project.

Project Funding Used for Non-Project Purposes

Another standard practice not followed for the Terminal Development Project by SBIAA management was to control finances so that project funding was not used for non-project purposes. Specifically, we found a Terminal Project payment voucher to fund rent credits for SBD Aircraft, which is a company that is not party to the Terminal Lease. The payment was made to SBIAA in the amount of \$137,527 and listed under the category "Airfield Pavement." The documentation attached to the voucher includes a letter from the Manager of SBD Aircraft¹⁷ to the Interim Executive Director. The letter states that under the Lease for Hangar 763, SBD Aircraft was restricted from accessing the Airfield Area and adjacent public streets due to pavement rehabilitation work.

No Controls Specific to Use of Contingency Funds

No specific procedures have been set up between SBIAA and the fund control agency to control the use of contingency funds. Although the Assistant Director asserted to our audit team in an interview that a "budget adjustment form" is required prior to the disbursement of contingency funds, we found no evidence of such requirement. Fund control agency staff asserted to our audit team that contingency funds are disbursed directly to the vendor. Additionally, there are no specifications in the fund control agreement with SBIAA requiring or even suggesting such a form. Further, in a review of a sample of Terminal Development and FBO project vouchers, we found no evidence of specific control procedures for the disbursement of contingency funds.

¹⁷ Scot Spencer

Table 2.9

GFOA Capital Project Best Practices vs. SBIAA Terminal Project

GFOA Finance Officials Best Practices for Capital Project Monitoring and Reporting	SBIAA Implementation of Terminal Development Project
Identify and incorporate legal and fiduciary requirements into capital monitoring and reporting.	<ul style="list-style-type: none"> ▪ All reviews handled by Rogers, Anderson, Malody, & Scott, LLP (RAMS) in consultation with Interim Executive Director. No audits conducted and CFO not involved in financial auditing or reporting of Terminal Project. ▪ No evidence that financial reporting was consistent with generally accepted accounting principles (GAAP).
Identify internal and external stakeholder information needs. Establish project performance measures.	<ul style="list-style-type: none"> ▪ Performance measures included in terminal lease, but not reported to Commission. ▪ Project updates not provided to Commission or Senior Management by CFO. ▪ Project management handled by Norton Development.
Plan and design systems to collect, store, and analyze project data and to report results.	<ul style="list-style-type: none"> ▪ Project financial data given to fund control agency, but its only obligation is to provide a report summarizing disbursements and available funds. ▪ No evidence that CFO or SBIAA management organized or analyzed project data from fund control agency during the project.
Regularly monitor capital projects' financial and project activity information.	<ul style="list-style-type: none"> ▪ Project scope and costs repeatedly supported by SBIAA management with little justification provided to Commission. ▪ No evidence of a project plan. ▪ CFO had limited involvement in reviewing project transactions. Primary expense approval by Interim Executive Director, Assistant Director, Commission Chair, and Developer.
Report on project status and activities.	<ul style="list-style-type: none"> ▪ Terminal lease required developer to provide status reports, but SBIAA management never enforced these provisions. ▪ No status reports provided to citizens or media by SBIAA management.
Ensure that actions are taken to finalize project activity at project close-out.	<ul style="list-style-type: none"> ▪ Project close-out activities handled by SBIAA management in consultation with RAMS. ▪ No CFO involvement in project close-out.

Source: GFOA Best Practice: Capital Project Monitoring and Reporting; Interviews with SBIAA management and staff; Review of Terminal Project Expense Vouchers and Reports

In our review of a sample of Terminal Development Project vouchers, we found disbursements of contingency funds for the following items:

- For the hire of a consulting firm to market SBIA to major commercial air passengers;
- For payments to Smarte Carte, Inc. for the lease of equipment;
- For payments to PHC, Inc. for work related to the refurbishment of gate furnishings;
- For the polishing of the airport monument (metal globe);
- For janitorial services; and,
- For fees associated with permits received from the City of San Bernardino.

In our review of a sample of FBO Project vouchers, we found disbursements of contingency funds for the following items:

- State of California flag and patio furniture;
- Over \$205,000 based on a vague description of project management including, “FBO completion, service implementation and administrative costs, ground equipment acquisition and activation, grand opening oversight and administration, scheduled service planning.”

Project Contingency Funds Used by Norton Development to Market Airport to Air Carriers

SBIAA management, including the Interim Executive Director and Assistant Director, has made multiple assertions to our audit team and others that Mr. Spencer has brought a unique and valuable set of aviation experience, knowledge, and contacts. Further, SBIAA management has asserted that much of the impetus to move forward with the Terminal Development Project came from Mr. Spencer’s assertions that he could attract a major commercial passenger air carrier.

Despite SBIAA management’s assertions of Mr. Spencer’s contacts and expertise in the aviation industry, a review of fund control vouchers has uncovered evidence to show that Mr. Spencer relied on an outside consulting firm to market the airport to major air carriers. Specifically, we found that Norton Development expended approximately \$37,000, possibly more, in Terminal Development Project contingency funds to utilize the services of a San Diego-based marketing firm. This firm was contracted to conduct market analysis, define a strategy for the airport, prepare air carrier presentations, and, if necessary, assist with delivery of presentations to air carriers. Invoices reviewed by our audit team indicate that an air carrier presentation was prepared for Hawaiian Air and that Air Tran was contacted to gauge interest. Further, this marketing firm was promised an incentive bonus if it attracted an air carrier to SBIA. These expenses occurred in December 2009 and July 2010.

Fund Control Standards Not Consistently Followed

Our review of Terminal Development and FBO Project expense vouchers have found several instances of payments made without the requisite signatures and payments made based on weak

documentation. In an interview with the fund control manager we learned that the fund control agency is unable to inspect soft costs as diligently as hard costs, which generally require an inspection of the building premises before fund dispersal. Fund control staff generally review the soft cost payment requests for (1) sufficient funds; (2) an invoice listing the amount requested and fund category as well as some documentation, such as a contract, to support the invoice; and, (3) the required three signatures.

Three Signatures Not Always Present Before Approval

Although the agreement between the fund control agency and IVDA required at least three signatures on each request for advance, we found several vouchers that did not have the requisite approvals. According to the agreement between IVDA and the fund control agency, “each request for Advance shall also be accompanied by an IVDA approval of the Request for Advance executed by either one of three authorized elected officials and any one of three authorized staff members of the IVDA.” The three authorized elected officials on the original agreement were Patrick Morris, Dennis Hansberger, and Robert Christman. The three authorized IVDA staff members on the original agreement were the Interim Executive Director, the Assistant Director, and the Chief Financial Officer.

The specific irregularities we found in our sample relating to signatures include:

- One voucher in our sample which lacks a signature from a designated IVDA staff person. While the voucher is signed by the Commission Chair and the developer (Scot Spencer), the line where a designated IVDA staff person is supposed to sign simply states “see attached.” The voucher was for a payment of \$103,338.50 to PHC Industries, Inc. for the refurbishment of gate seating.
- Three vouchers in our sample which lack a signature from a designated staff member of Norton Development. Two of these vouchers simply do not include a signature from Norton Development while the third voucher states “see attached.” The documentation attached to the third voucher consists of a list of expenses and a calculation of the developer fee (1.35%). The documentation is signed by the accountant for Norton Development, who is not listed as a designated signer for payment requests.
- Two vouchers from our sample which lacked any signatures. One of these vouchers was for a payment request of \$6,145.20 in construction management fees. The second voucher was for a payment request of \$21,752.41 in developer fees.

Weak Documentation Provided for Some Expenses

The agreement between IVDA and the fund control agency specifies that “each request for advance shall be accompanied by a Contractor certification to California Fund Control [(now First American Fund Control)] that all information included within a Request for advance shall be true, accurate and not subject to qualification.” Although not required by the agreement, fund control agency staff often requested backup documentation, such as a contract, to support the release of funds.

In the sample of payment vouchers we reviewed, we found several vouchers that were accompanied by weak or erroneous documentation. These instances include:

- A payment request submitted in May 2009 for \$17,600 to be paid to “Better Books and Payroll.” The payment request is accompanied by invoices from Better Books and Payroll, but does not include a contract between Better Books and Payroll and SBD Aircraft Services (a company that is not party to the Terminal Lease) and does not include a Tax ID number. Further, it is unclear why SBD Aircraft Services hired the services of an outside accountant when there was a full time accountant on staff with Norton Development.
- A payment request submitted in December 2009 in the amount of \$400. The attached documentation consists of an image of a Norton Development check made out to “Petty Cash” for \$400.
- Several payment requests submitted for payment of developer fees that do not include either a list of expenses or the calculation of the 1.35% fee. Several payment requests include a list of expenses with the developer fee calculated, but do not contain a signature of the staff member who made the calculations.
- Two payment requests submitted for payment to Norton Aircraft Maintenance Services (NAMS), another company with ties to Mr. Spencer. The first of these vouchers was submitted in June 2010 for an amount of \$18,665.47. This voucher includes an invoice from NAMS for various materials and supplies, as well as a list of employees with number of hours worked, but does not include timesheets or a detailed description of the work completed. The second request submitted for payment to NAMS was in August 2010 for an amount of \$21,078.32. This voucher includes invoices from NAMS which state the amount of hours worked and list various materials and supplies. This second voucher does not include a list of employees with hours worked, any timesheets, or a detailed description of the work completed.
- Several payment requests for construction management which include timesheets for staff time that don’t match the dates listed on invoices. These instances include:
 - Voucher 69567, which includes an invoice for construction management hours by Norton Development staff for the time period between December 29, 2008 and February 20, 2009. The timesheets attached are for the period between February 2 and February 20, 2009.
 - Voucher 69566, which includes an invoice for construction management hours by the Norton Development accountant for the time period between December 28, 2008 and February 20, 2009. The timesheets attached are for the period between February 1 and February 21, 2009.
 - Vouchers 69776 and 69777, which have similar inconsistencies as Vouchers 69567 and 69566. These vouchers include invoices that list time periods (and

therefore amount requested) that conflicts with timesheets submitted for construction management fees by Norton Development staff.

- At least one instance of a double billing for construction management fees. Specifically, on July 17, 2008, a request was submitted for payment to SBD Aircraft Services for \$15,440 for construction management fees based on hours worked. Subsequently, on August 14, 2008 Norton Development submitted a request for payment of \$34,540 for construction management fees. One month of time, or about \$1,200, was double charged for the Executive Assistant of Norton Development. Further, duplicative timesheets were submitted for the Manager of Norton Development for a month (from June 16, 2008 to July 13, 2008). Both the SBD Aircraft Services request and the Norton Development request list the Manager as an employee of Norton Development.
- Several payment requests for construction management fees include timesheets with identical allotment of hours to each day of the week. The duplicative timesheets suggest that the developer might not have accurately reported actual hours worked.

Conclusions

SBIAA management proceeded with the Terminal Development and Fixed Based Operation (FBO) projects in a manner contrary to industry standards for large public infrastructure projects. Specifically, SBIAA management did *not* (1) conduct competitive bidding for general contractor services; (2) adhere to a clearly stated compensation structure for Norton Development Company, LLC (Norton Development) and SBD Properties, LLC (SBD Properties); (3) base the Terminal Building design substantially on transparent and methodical analysis of anticipated passenger traffic; (4) report a clearly defined budget to the SBIAA Commission throughout the project; and, (5) utilize clear and effective policies and procedures.

SBIAA management expedited and substantially increased the scope of the Terminal Development Project. These changes were based on assertions from the contractor with whom management intended to hire as the project developer through a sole source contract. This created a clear conflict of interest, since the developer has been paid on a percentage-of-project-cost basis and any increases in project cost leads directly to increased compensation for the developer. Such changes were largely based on assertions by the contractor of (1) major commercial passenger air carrier interest in SBIA; (2) prospective air carrier infrastructure requirements; and, (3) more aggressive passenger traffic projections. The validity of these updated projections, interest, and demands are unclear and unsubstantiated. Further, the updated projections and resulting schematic design led to significantly higher costs, including \$9 million for a two-story concourse, over \$4 million for major aviation equipment, and \$2.7 million to fast track the project. Notably, the scope and cost of the Terminal Development Project grew incrementally from approximately \$22 million, based on an initial design in January 2006, to over \$100 million budgeted as of January 2011 with work and costs continuing to escalate.

Similar to the Terminal Project, SBIAA management allowed the same development contractor (through a separate company) to define the design and scale of the FBO project, leading to

substantially higher costs. Likewise, the scope and cost of the FBO Project grew incrementally from \$5 million in March 2007 to over \$33 million as of January 2011, with approximately \$30 million actually expended as of that date.

SBIAA management has managed the Terminal Development and FBO Projects with insufficient controls. These control weaknesses have included: (1) the absence of sufficient policies and procedures; (2) the lack of an independent audit for either project; (3) poorly written leases that provide for little contractor oversight; and, (4) an opaquely written and implemented compensation structure for the two development companies.

The fund control process has (1) alienated the Chief Financial Officer from day to day financial oversight of major construction projects, and (2) resulted in poor budgetary controls.

Recommendations

The SBIAA Commission should:

- 2.1. Immediately require SBIAA management to strengthen controls and reporting to the Commission including:
 - a. Implementing procedures for the use of contingency funds for existing and future capital projects.
 - b. Requiring Chief Financial Officer review and approval of all expenses prior to disbursement of capital project funds.
 - c. Enforcing all provisions in the Terminal and FBO leases requiring the developer to provide detailed monthly progress reports. The Commission should also require the developer to provide and present such reports at Commission meetings.
 - d. Engage the services of a reputable, independent auditing firm to examine all expenses incurred as a result of the Terminal Development and FBO Projects. The scope of such an audit should include a review of construction meeting minutes to determine if the developer purposely inflated costs.

Costs and Benefits

There would be no cost to implement these recommendations.

Capital construction projects will be appropriately scoped, costs will be contained and transparently reported, and projects will be more economically implemented. Without immediate implementation of the recommendations, Norton Development and SBD Properties will likely continue to spend taxpayer funds without being subject to proper controls.

3. Equipment Acquisition

- **SBIAA management did not conduct proper due diligence prior to purchasing major aviation equipment for the new terminal building. SBIAA management did not fully assess its terminal building equipment needs, determine whether the used equipment that it purchased was appropriate given specifications driven by the terminal building design, or consider long term costs when deciding whether to purchase used instead of new equipment.**
- **In addition, the SBIAA Interim Executive Director made multiple representations to the SBIAA Commission regarding the terms of the aviation equipment purchase agreement with Norton Development Company. However, the acquisition approach, as well as the number and pricing of the equipment items changed substantially after the Commission's approval of the purchase.**
- **SBIAA management never signed or executed a contract with Norton Development Company for the purchase, refurbishment, delivery, or installation of the used aviation equipment. Rather, the terms of the agreement were later stated in a letter from the Manager of Norton Development to the Interim Executive Director in February 2008. The terms of this letter are substantially different from those described to the Commission by the Interim Executive Director in July 2007. A subsequent letter to the Interim Executive Director in August 2008 stated that the terms, as discussed with the Director, had been altered. These further changes resulted in higher costs to SBIAA.**
- **SBIAA has insufficient internal controls, including policies, procedures, and audits for acquiring aviation equipment. There is no internal process for verifying price, quantity, or condition of aviation equipment. Further, the fund control process does not ensure that SBIAA receives a fair and accurate price for the used equipment. Additionally, the review conducted of the Terminal Development Project was not an audit and did not review the acquisition of the used aviation equipment.**

Rather than proactively and comprehensively assessing its equipment needs and conducting a formal procurement process as part of the Terminal Development Project, SBIAA management entertained an offer from the Manager of Norton Development Company, LLC (Norton Development) to acquire, transport, and refurbish used aviation equipment from American Airlines and fixed based operations equipment from Blue's Aviation.¹ SBIAA management responded to the offer from the Manager of Norton Development by quickly preparing a staff report and resolution supporting the purchase. There is little evidence to suggest that proper due diligence was conducted prior to the authorization by the Commission. In addition, it appears that pressure was placed on the Commission to make a decision quickly. The staff report was

¹ Blue's Aviation was contracted by SBIAA to manage fixed based operations at the Airport until the company was sold in 2007 to SBD Aircraft Services, LLC, the Airport's master tenant at the time.

presented at a special meeting of the Commission on the afternoon of July 3, 2007 (one day before a national holiday), after which Resolution 2007-05 was approved, authorizing the purchase. Further, under *Background and Comments*, the staff report on Resolution 2007-05 states,

The reason for this special opportunity relates to the timely closing of a major terminal in New York coincidental to our needs in San Bernardino. The seller of that equipment is anxious to have the equipment removed from the New York facility so that their demolition and remodel of that facility can begin. They are under some pressure to sell quickly.

SBIAA Management Did Not Conduct Proper Due Diligence

SBIAA management did not conduct proper due diligence prior to purchasing several pieces of major aviation equipment for the new terminal building. SBIAA management did not fully assess its terminal building equipment needs, determine whether the used equipment that it purchased was appropriate given the specifications of terminal building design, or consider future costs when deciding whether to purchase used equipment instead of new equipment.

Vague Representations Made to SBIAA Commission on Due Diligence

Although the Interim Executive Director made certain representations to the SBIAA Commission as to the level of due diligence conducted when considering the purchase of the used aviation equipment, these representations were vague and lacked sufficient supporting documentation. The staff report the Interim Executive Director presented to the Commission at the special meeting held July 3, 2007 included three vague references that suggested that due diligence had been conducted prior to recommending the purchase of the equipment. The first reference stated that, “Staff has made significant inquiries to assure that the prices being paid are very low compared to any available alternatives for procuring such equipment.” However, SBIAA management did not provide the Commission or our audit team with documentation demonstrating the full findings or depth of such inquiries beyond a spreadsheet. This spreadsheet, which was attached to the invoice from Norton Development and placed on file with the Clerk of the Board, merely lists the estimated new cost and used value for some, but not all, of the equipment to be purchased. Without supporting documentation from a manufacturer or distributor, it is not possible to verify the basis for the estimates or the comparison of costs for new equipment.

The second reference to due diligence in the staff report states that, “The manufacturers have been contacted to verify the condition as operable prior to delivery to San Bernardino.” However, the report does not specify who contacted the manufacturers (either SBIAA staff or Norton Development staff) and, more importantly, does not provide information on the condition of the jet bridges beyond that they are “operable.” Further, representatives from SBIAA, Norton Development, and GKK Works (the Architectural and Engineering Contractor for the Terminal Development Project) did not conduct visual inspections of the equipment until three weeks after the Commission authorized the acquisition agreement.

The third reference to due diligence states that “Representatives of BAA, consultants to Norton Development Company, have inspected the equipment in New York and they have determined

that the equipment is mostly suitable for our needs in San Bernardino.” This representation has not been verified, and no documentation had been provided to the Commission, or subsequently to our audit team, to substantiate this assertion. When questioned about the relationship between Norton Development and BAA, the Manager of Norton Development commented that BAA is an airport management firm, based in the United Kingdom, that “did a preliminary look” at the used equipment located at New York’s John F. Kennedy International Airport. This determination should not be considered proper due diligence by SBIAA, since the consultants would have been representing the interests of the seller, Norton Development, and not the buyer, SBIAA. Further, no written documentation of the results of the inspection has been made available.

SBIAA Management Did Not Fully Assess its Terminal Equipment Needs Prior to Acquisition

SBIAA management did not conduct a comprehensive assessment of its Terminal Building equipment needs prior to requesting that the SBIAA Commission authorize over \$4 million to be used for the purchase of used aviation equipment from Norton Development.² The absence of this formal assessment may have led to the purchase of excess and inappropriate equipment and unnecessary additional costs to SBIAA.

As discussed in more detail in Section 2 of this report, at the most basic level, it is questionable whether SBIAA needed to even purchase jet bridges at this stage of airport development. In fact, the initial Terminal Space-Needs Study found that such equipment would not be necessary for the first 15 years of terminal operations. This initial study was subsequently updated with more aggressive passenger traffic projections supplied by the Manager of Norton Development, which resulted in the assumption that jet bridges would be needed for the terminal. While it may be appropriate to consider the purchase or installation of jet bridges at some future time, the airport could have operated with mobile stairways during an interim period, until passenger traffic levels justified such expenditures. Mobile stairways are used at multiple airports in the West, including Burbank and Long Beach. Had mobile stairways been used instead of jet bridges, SBIAA could have saved several million dollars that was instead paid to the contractor.

There is little evidence to suggest that SBIAA management verified that the jet bridges purchased from Norton Development would meet two basic specifications at San Bernardino International Airport. Two of the specifications generally considered when purchasing passenger boarding bridges (jet bridges) are: (1) the height of the terminal floor where the jet bridge will connect to the building and (2) the types of aircraft to be serviced by the jet bridges (to ascertain the height of the aircraft passenger door floor from the ground). These two specifications are used to determine the length of the jet bridge ramp required to reach from the terminal floor to aircraft door floor and maintain a federally mandated slope of 8.33% or less.³ Further, the used jet bridges that were purchased were originally designed for use by American Airlines at New York’s John F. Kennedy International Airport (JFK) in the 1970s, 1980s, and early 1990s, before the widespread use of regional jet aircraft. The April 2007 *SBD Terminal Schematic Design*

² Norton Development Company, LLC is a limited liability company that was created in May 2007 by the Manager of SBD Aircraft Services, LLC in order to develop the San Bernardino International Airport Terminal Building.

³ The Federal Government requires a slope of 8.33% or less under the Americans with Disabilities Act.

Report, which was used for the Terminal Development Project, projects an equal mix of regional jets and main jet aircraft at the gates planned for the first two operational phases of the terminal building. This report should have influenced design and equipment purchasing decisions by SBIAA, but the evidence we have collected suggests it was disregarded.

The jet bridges that were refurbished and installed at the Terminal Building by Norton Development appear to be inadequate for use with some regional jet aircraft without the aid of other expensive equipment. Specifically, the door floor (“sill”) heights of some regional jet aircraft are as low as five feet and four inches (5’4”) from the ground. In order for a jet bridge ramp to reach from the SBIA Terminal Building floor (15 feet) to the sill of these regional jets (5’ 4”) and maintain a slope of 8.33% or less, the jet bridge would have to be at least 109 feet and 5 inches long.⁴ The three jet bridges that have been refurbished and installed at the SBIA terminal gates have a maximum extended length of 80 feet, 84 feet, and 85 feet, thereby making them inadequate, without additional equipment, to reach some regional jets, as illustrated in Table 3.1 below. Walkways would be required to reach the regional aircraft with sill heights of less than 7 feet and 4 inches for the 85 foot extended length jet bridge, or 7 feet and 9 inches for the 80 foot extended length jet bridge.

Table 3.1

Installed Jet Bridge Ability to Service Various Aircraft

Aircraft	Aircraft Type	Sill Height	Required Ramp Length	Reached Unaided with Installed Bridges?
Canadair Regional Jet 200	Regional Jet	5 ft & 4 in	109 ft & 4.3 in	No
Canadair Regional Jet 700	Regional Jet	5 ft & 8 in	105 ft & 3.3 in	No
Canadair Regional Jet 705	Regional Jet	5 ft & 8 in	105 ft & 3.3 in	No
Canadair Regional Jet 900	Regional Jet	5 ft & 8 in	105 ft & 3.3 in	No
Embraer ERJ 145	Regional Jet	4 ft & 10 in	115 ft & 4.3 in	No
Embraer ERJ 170	Regional Jet	8 ft & 4 in	73 ft & 4.2 in	Yes
Embraer ERJ 195	Regional Jet	8 ft & 4 in	73 ft & 4.2 in	Yes

Source: Canadair and Embraer

⁴ The ramp length requirement was calculated by subtracting the sill height and 0.56 feet (to account for a step inside the jet bridge) from the height of the Terminal floor. The remainder was divided by 0.0833 to account for the Federally mandated slope of 8.33% or less.

On tours of the terminal facilities and terminal equipment on January 4, 2011 and March 2, 2011 respectively, our audit team was told by the Manager of Norton Development⁵ that the walkways were acquired to meet certain fire code standards established to minimize fire risk to the occupants of the terminal building in the event of a fuel fire. Specifically, our audit team was told that the walkways extended the distance between the planes and the terminal building during the fueling process, thereby negating the need to acquire additional costly fire suppression materials. This reasoning was also asserted by the Interim Executive Director and the Assistant Director of SBIAA. Our research indicates that these distances could have been accommodated by even the shortest purchased jet bridge, without additional costly equipment or fire suppression systems. National Fire Protection Association (NFPA) Section 407, Subsection 5.10.2 states that, "Aircraft being fueled shall be positioned so that aircraft fuel system vents or fuel tank openings are not closer than 7.6 m (25 ft.) to any terminal building, hangar, service building, or enclosed passenger concourse other than a loading walkway." The two shortest purchased jet bridges have a minimal length of 21 feet and 41 feet respectively and can extend to 29 feet and 56 feet. The other purchased jet bridges have maximum extensions between 85 and 99 feet. Since we are not experts regarding fire safety standards at airports, we requested the applicable fire code citation used to justify the walkways in writing from the Manager of Norton Development, as well as from SBIAA management. However, our audit team never received a response to either request.

From the review of documentation provided by SBIAA and a sample of project vouchers we estimate that the walkways cost SBIAA at least an additional \$217,267, or \$72,422.21 per installed jet bridge, as the walkways were not part of the initial acquisition authorization. The walkways were never mentioned by the Interim Executive Director in the July 3, 2007 staff report to the Commission and they were not included in the list of *Aviation Equipment to be Acquired* on file with the Clerk of the Board, which was referenced in the staff report. The additional costs that we were able to confirm were for the transport and refurbishment of such walkways. Further, none of the remaining jet bridges yet to be installed are able to be lowered sufficiently to reach these regional jet aircraft without the aid of a walkway. The cost of outfitting the remaining jet bridges, at the same cost, would total an additional \$619,378.

SBIAA Management Did Not Conduct Life-Cycle Cost Analysis Prior to Purchasing Used Aviation Equipment

SBIAA management did not conduct a life-cycle cost analysis before proceeding with the purchase of major aviation equipment, some of which is more than 35 years old. The use of life-cycle cost analysis could have provided a clear and complete assessment, by considering short and long-term costs, of the alternatives available to SBIAA for purchasing aviation equipment.

Life cycle cost analysis is an evaluation technique that considers all of the costs incurred during the period over which the alternatives are being compared. Since large transportation investments, such as the Terminal Building equipment, will provide service to the public for many years, the investment decisions should consider not only the initial cost, but also the future costs. Future costs in this case would include maintenance and replacement of weathered and outdated equipment. Life cycle cost analysis is relatively simple and could have been completed

⁵ Scot Spencer

by SBIAA in a short period of time. Further, there are resources made available online for free from the U.S. Department of Transportation to assist in conducting life cycle cost analysis. Unfortunately, SBIAA management did not consider the future costs of maintenance and replacement of equipment before proceeding with the purchase of used aviation equipment from Norton Development.

Acquired Equipment Likely to Have a Short Lifespan

The used aviation equipment acquired through Norton Development, in particular the jet bridges, are likely to have a shortened useful lifespan for SBIAA as compared to their modern counterparts, which could have been purchased new. The used jet bridges purchased range in age from 20 years to 36 years. According to representatives from one jet bridge manufacturer, jet bridges generally have a lifespan of 20 years, but this could be extended if proper maintenance is conducted throughout the life of the equipment. As previously mentioned, there is little evidence to suggest that SBIAA management conducted a thorough inspection of the condition of the used equipment. Specifically, staff from SBIAA and GKK Works (the Architectural and Engineering contractor) did not conduct a visual inspection of the equipment until *after* the Commission approved the authorization and the equipment was acquired by Norton Development. Prior to being acquired by SBIAA through Norton Development, this equipment was installed at New York's JFK Airport, located less than two miles from the Atlantic Ocean in an area with a relatively high level of inclement weather conditions. Additionally, the ground power units are very old. At least two of the ground power units were manufactured more than 30 years ago.

On a visual inspection of the un-refurbished jet bridges and ground power units by our audit team, we found that the majority of such equipment is in very poor condition and is being stored outside without sufficient protection from the elements. Attachment 3.1 to this report contains photos of the un-refurbished equipment as seen on this visual inspection.

Substantial Changes in Acquisition Approach and Terms Made Without Subsequent Approval by Commission

Following Commission approval on July 3, 2007, substantial changes occurred in the terms and acquisition approach of the used aviation equipment from Norton Development. Further, these changes were not subsequently approved by the Commission. Specifically, the Sale and Purchase Agreement was never executed by SBIAA management and the number and pricing of such equipment changed from what was presented to the Commission.

No Sale and Purchase Agreement Signed or Executed

No Sale and Purchase Agreement was executed between SBIAA and Norton Development despite representations made to the Commission by the Interim Executive Director as well as several references in SBIAA Commission Resolution 2007-05 suggesting that such an agreement would be executed. The failure to execute the Sale and Purchase Agreement with Norton Development has left SBIAA with little, if any, contractual protections and Norton Development with little to no legal obligation and no official list of equipment, condition, or purchase price for which it can be held accountable.

In the absence of an executed Sale and Purchase Agreement, SBIAA management and Norton Development have treated the authorization from the Commission for the acquisition not to exceed \$4,060,000 (a ten percent contingency brings the total not to exceed amount to \$4,466,000) as the de facto purchase price for all of the equipment. There is little evidence to suggest that SBIAA management or Norton Development made serious efforts to contain the costs within that authorization. To date, the total amount spent on equipment acquisition has exceeded \$4.3 million. This amount does not include the costs to purchase, transport, or install a sixth refurbished jet bridge (11th jet bridge overall to be delivered to SBIA) nor does it include the cost of purchasing escalators and public address systems, which were to be acquired within the authorized amount. Further, this amount does not include soft costs such as developer fees, construction management fees, or travel costs.

The Interim Executive Director made at least two representations to the SBIAA Commission that a Sale and Purchase Agreement would be executed between SBIAA and Norton Development for the purchase of used aviation equipment. These representations were made in a staff report to the SBIAA Commission at a special meeting held on July 3, 2007. Specifically, the first reference to the agreement in the staff report, under the heading *Financial Impact*, states “The initial deposit of ten percent (10%) or \$406,000, will be paid upon signing the Sale and Purchase Agreement...” The second reference to the agreement in the staff report, under the subtitle *Background and Comments*, states “A Sale and Purchase Agreement is on file with the Secretary of the Commission which Agreement will be executed between SBIAA and Norton Development Company.”

Resolution 2007-05, approved by the SBIAA Commission at a special meeting on July 3, 2007, clearly states in several instances that the Commission’s intention is to enter into a written, executed Sale and Purchase Agreement with Norton Development for the acquisition of used aviation equipment. The Resolution has over 15 references to the agreement including in its title, which states, in part, “authorize execution of a sale and purchase agreement for the acquisition of said equipment.” Shortly thereafter, the preamble of the resolution states that “the Commission intends to enter into a Sale and Purchase Agreement with the Developer.” Further, Section 4 of the resolution states “The Commission hereby authorizes either the President or the Vice-President together with the Executive Director or his designee to approve each expenditure for the Aviation Equipment pursuant to the Sale and Purchase Agreement on behalf of SBIAA in accordance with the Sale and Purchase Agreement.”

Terms of Equipment Purchase Defined in Letters to Executive Director

February 22, 2008 Letter

In lieu of an executed Sale and Purchase Agreement, SBIAA management and Norton Development have relied on two letters written by the Manager of Norton Development to the Interim Executive Director of SBIAA as the basis of the agreement. The first letter, dated February 22, 2008 and included as Attachment 4.2 to this report, states that it:

confirms the understanding of San Bernardino International Airport Authority and Norton Development Company, LLC regarding the purchase of certain equipment from American Airlines, Inc. by Norton at the

request of SBIAA in connection with the refurbishment of the Terminal at the Airport, and the use of the proceeds under the Loan Agreement...to pay for that equipment.

The letter lists the “equipment in question” as

eleven (11) Jetway Loading Bridges (six (6) of which will be refurbished before delivery to the Airport), ten (10) Ground Power Units⁶, ten (10) Potable Water Cabinets, five (5) Baggage Carousels, the Terminal Public Address System and Gate Furniture as further set forth in Exhibit A.

Noticeably absent from this list, but listed in the July 3, 2007 staff report (see Table 4.2 and Table 4.3 for a full comparison) are the 12th jet bridge, 11th and 12th ground power units, 11th and 12th potable water cabinets, four escalators, and 10 individual gate public address systems. Each of these absent items were listed as major items of equipment to be acquired in the Interim Executive Director’s staff report to the SBIAA Commission at its special meeting held on July 3, 2007.

Norton Development’s responsibilities, as stated in the February 2008 letter, were to “supply and construct the Improvements (as defined in the Terminal Lease) in compliance with the Plans and Specifications (as defined in the Terminal Lease).” The letter also states that Norton Development will refurbish six Jetway loading bridges in Texas. The letter further states that “Norton is responsible to arrange for any required disassembly of the aviation equipment, the packaging, loading, insuring and shipping of same from the current location or locations of the aviation equipment and shall cause the same to be transported via truck or other suitable shipping method to the Airport and delivered to a location on the Airport as may be designated by SBIAA.”

The purchase prices for the jet bridges, as stated in the February 2008 letter, were \$119,910 for each jet bridge. The letter states that this amount “includes all removal, packing and shipping costs *and when applicable refurbishment cost*” (emphasis added). The letter further states that this amount “does not include the cost of unloading, placement into storage or installation in San Bernardino.” Despite this language, our audit team was able to confirm that at least \$90,862 was charged to SBIAA for transport of walkways and jet bridges. Of this amount, \$55,562 was charged for transport of walkways and at least \$35,300 was charged for transport of jet bridges. The purchase prices, as listed in the February 2008 letter, for each baggage carousel system was \$235,000. The letter states that this price “includes all removal, packing, shipping, and refurbishment costs, however, it does not include installation costs.”

August 4, 2008 Letter

The second letter, dated August 4, 2008 and included as Attachment 4.3 to this report, states that it reflects a “revised understanding of SBIAA and Norton Development Company, LLC and supersedes” the previous understanding regarding the purchase of the used aviation equipment.

⁶ Ground power units are equipment used for supplying electric power to an aircraft on the ground to sustain interior lighting, ventilation, and other requirements before starting of the main engines or the aircraft auxiliary power unit.

The August 2008 letter from the Manager of Norton Development to the SBIAA Interim Executive Director contains two significant changes from the February 2008 letter. The first change is inclusion of the statement that “SBIAA acknowledges that it is in the best interest of SBIAA and the project for Norton [Development] to accomplish the Additional Scope Items described in Exhibit B.” Exhibit B, which is introduced in the August 2008 letter, includes a list of items accompanied by prices totaling \$14,779. These include:

- New Cab Curtains \$6,500
- New Cab Curtain Flashing \$800
- New Tires and Tubes \$1,200
- Repair Transition Ramp and Replace Handrails \$1,779
- Elastomeric Roof Coating \$500
- New Rotunda Curtain \$4,000

The purchase prices for the jet bridges, as stated in the August 2008 letter were “\$119,910 for each Jetway which has not been refurbished” and “\$134,689 for each refurbished Jetway.” The total additional cost under the revised price is \$88,674, or \$14,779 per jet bridge. The letter states that these payments (\$119,910 for un-refurbished jet bridges and \$134,689 for refurbished jet bridges) includes “all removal, packing and shipping costs and when applicable refurbishment cost, however, it does not include the cost of unloading, placement into storage or installation in San Bernardino.”

In addition to the \$88,674 spent on “additional scope items” as noted in the August 4, 2008 letter, SBIAA spent approximately \$53,000 on items noted as “extra work” on six fund control vouchers. The majority of the “extra work” was for jet bridge and walkway refurbishment.

Amount of Aviation Equipment Purchased Was Not Consistent with Plans and Specifications, as Defined in the Terminal Lease

The amount of aviation equipment purchased from Norton Development was significantly more than what was called for in the Terminal Lease. Although the February 2008 and August 2008 letters both state that Norton Development has acquired the aviation equipment in accordance with the Terminal Lease, the lease calls for significantly less aviation equipment than what was acquired. Specifically, all references to improvements or aviation equipment state that three terminal gates are to have jet bridges with one hardstand⁷ ground passenger boarding area. While the April 2007 SBD Terminal Schematic Design, updated with more aggressive passenger projections provided by the Manager of Norton Development, called for three gates in the first year, six gates in the second year, and nine gates in the third year of operation, the Terminal Lease only called for three gates with jet bridges for Phase 1 of the project.

⁷ Hardstand boarding areas consist of a stairway from the Terminal Building to the ground. Passengers typically walk down the stairs to board turboprop aircraft or to board a plane using mobile staircases.

The Terminal Lease has at least two references stating that *three* jet bridges are to be installed at the Terminal Building. Under Definitions in Article 1 of the Lease (Definitions), “Improvements” includes:

- (i) three (3) terminal gates with jetways to be located in an elevated concourse and one (1) hardstand ground level passenger boarding area,
- (ii) corresponding departure lounges, restrooms, access stairways, escalators, elevators, operational support facilities, baggage claim and conveyor belt systems, security screening areas, concessions areas, office support areas and hardstand gates as may be required by SBIAA, and
- (iii) the first phase of the concourse construction, remodeling and renovation project comprising the Improvements.

The Terminal Lease again calls for three terminal gates with jet bridges by repeating this language under Article 4 (*Lease and Use of Demised Premises*) and Exhibit A (*Agreement for Acquisition of Improved Terminal Building*). Further, Amendment No. 2 to the Terminal Lease again calls for “three (3) terminal gates with jetways.”

Amount of Equipment Items Reduced, but Price Never Adjusted to Reflect Such Changes

As previously mentioned, the amount of equipment items presented to the Commission by the Interim Executive Director at the Commission’s special meeting on July 3, 2007 does not reflect the amount of items actually acquired from Norton Development. Further, the price of acquiring such equipment was never adjusted by Norton Development to reflect these differences. Specifically, according to the Interim Executive Director’s July 3, 2007 staff report to the Commission, the initial payment of \$406,000 was to be an initial deposit of ten percent. However, there has been no corresponding reduction of this deposit to reflect the reduced amount of equipment. Further, expenditures to date have exceeded the original not to exceed amount of \$4,060,000 authorized by the Commission despite the reduction in the number of equipment provided. Further, the cost of purchasing the sixth refurbished jet bridge (11th jet bridge overall), which is still being refurbished in Texas, will bring the total amount spent on used equipment from Norton Development in excess of \$4.5 million and therefore above the sum of the not to exceed amount plus the ten percent contingency (\$4,466,000). It is unclear whether SBIAA management intends to formally address this issue with the Commission.

Table 3.2 below lists the items to be acquired from Norton Development Company as listed in the July 3, 2007 staff report presented to the SBIAA Commission by the Interim Executive Director.

Table 3.2

**List of Major Items of Equipment to be Acquired
According to Staff Report to Commission**

Equipment Type	Number of Units	Purpose
Sky Bridges	12	Terminal Building
Ground Power Units	12	Terminal Building
Baggage Handling Equipment and Carousel	3	Terminal Building
Escalators	4	Terminal Building
Passenger Furniture (Chairs)	12 gates (~216 chairs per gate)	Terminal Building
Terminal Master Public Address System	1	Terminal Building
Individual Gate Public Address Systems	10	Terminal Building
Main Deck Cargo Loader	1	Fixed Based Operations
Electric Generators	2	Fixed Based Operations
Lift Trucks	4	Fixed Based Operations
Fuel Tank Farm- 12,000 gallons	1	Fixed Based Operations
Jet A Fuel Tank Farm- 12,000 gallons	1	Fixed Based Operations
Jet A Fuel Truck	1	Fixed Based Operations
Fuel Trucks	4	Fixed Based Operations
Portable Water Carts	12	Terminal Building

Source: Interim Executive Director Staff Report to SBIAA Commission dated July 3, 2007

Table 3.3 on the next page lists the equipment provided or to be provided according to the two letters sent to the Interim Executive Director from the Manager of Norton Development. Notably, the staff report lists 12 Sky Bridges, but only 10 have been provided (Norton is still arranging for off-site refurbishment of an 11th bridge). Additionally, the staff report lists 12 Ground Power Units and 12 portable water cabinets, but Norton Development states that it will only provide 10 of each. Further, four escalators and 10 individual gate public address systems are listed, but neither are mentioned as equipment to be provided in the letters from Norton Development.

Table 3.3

**Aviation Equipment to be Acquired
According to Letters from Norton Development**

Equipment Type	Number of Units	Notes
Jet bridge Loading Bridges	11	6 to be refurbished before delivery to the Airport
Ground Power Units	10	-
Potable Water Cabinets	10	-
Baggage Carousels	5	4 to be refurbished
Terminal Public Address System	1	-
Gate Furniture	Not specified	-

Source: February 22, 2008 and August 4, 2008 letters from Norton Development to SBIAA Interim Executive Director

Gate Seating Provided is Significantly Less than Amount Presented to Commission at a Significantly Higher Cost

There is sufficient evidence to suggest that Norton Development has supplied less than half the number of passenger seating than was represented to the SBIAA Commission by the Interim Executive Director. In the July 3, 2007 staff report to the SBIAA Commission, the Interim Executive Director noted that the equipment to be acquired [through Norton Development] included “Passenger furniture (chairs) sufficient for 12 gates (approximately 2,600 chairs).” Further, a review of the list of *Aviation Equipment to be Acquired* on file with the Clerk of the Board shows that 2,520 seats (or 210 seats per gate for 12 gates) were to be acquired. However, a review of funding documents show only 820 seats, or about 32 percent of what was represented in the Staff Report, have been provided. Additionally, an extra 132 upholstered shells (without bases) have been provided for replacement inventory.

SBIAA has paid well over twice the amount originally estimated in the list of *Aviation Equipment to be Acquired* referred to in the July 3, 2007 staff report to the Commission and on file with the Clerk of the Board. While the list of *Aviation Equipment to be Acquired* lists the used estimated value of 2,520 chairs at \$100,000, SBIAA has paid out over \$273,000 in funds related to the acquisition of such chairs as detailed in Table 3.4 on the next page. Given these costs, SBIAA has spent over \$308 per chair.⁸ Purchasing the same number of chairs new, estimated by SBIAA at \$130 per seat, would come to a total cost of approximately \$115,000. Therefore, according to SBIAA calculations, it would have cost less than half to purchase the chairs new compared to what was paid through the arrangement with Norton Development.

⁸ This amount was calculated by dividing the total seating cost (\$273,141) by the number of assembled seats (820) and half the number of replacement shells (66 is 50% of the total number of replacement shells).

Table 3.4**Gate Seating Costs**

Cost Type	Amount
Disassemble Chairs	\$9,241
Transport of Chairs from JFK to Camden, NJ	20,000
Refurbishment & Materials	199,275
Storage Fees	44,625
Total	\$273,141

Source: *Summary of Used Equipment Acquisitions from Norton Development Company Originally Authorized July 3, 2007* (provided by SBIAA) and Terminal Development Project Fund Control Vouchers

Soft Costs Not Included in Cost Estimate of Equipment Acquisition

In addition to the hard costs reimbursed by SBIAA for the acquisition, transport and refurbishment of used aviation equipment, several thousand dollars of soft costs were submitted by Norton Development Company for coverage under Terminal Development Project funding. These costs include approximately \$55,000 in developer fees to Norton Development, which is calculated as 1.35% of the total cost. In addition, approximately \$6,650 was spent on travel to New York to view the equipment at JFK Airport. Of this \$6,650, approximately \$2,500 went to cover travel expenses for Norton Development Company staff, including the Manager, and an additional \$2,500 went to cover travel expenses for GKK Works (the Architectural and Engineering contractor) staff.

SBIAA Lacks Adequate Policies and Procedures, Internal Controls for the Acquisition of Aviation Equipment

SBIAA lacks adequate controls, including policies and procedures, for purchase of major equipment for the Terminal Development Project. Policies and procedures, which are inadequate, have been ignored for the purchase of major aviation equipment. Further, the internal control structure set up by SBIAA management for the purchase of major aviation equipment is not sufficient to protect the interests of the Authority and has not ensured that the Authority receives quality products at competitive prices.

Policies and Procedures are Inadequate for High Dollar Value Procurement

The purchasing policy for the Inland Valley Development Agency (IVDA) and SBIAA, entitled *Purchasing Policies and Change Order Procedures* is inadequate for general procurement and specifically for procurement of major aviation equipment. The Purchasing Policy is outdated, lacks evidence of Board or Commission approval, appears unfinished, and lacks sufficient detail for certain types of purchases. Despite these inadequacies, the purchasing policy includes certain procedures which could have been followed for the procurement of major aviation equipment, but were ignored by SBIAA management. These procedures would have provided some basic

controls to reduce the risk of purchasing products above market rates, below acceptable quality conditions, or beyond the budgetary constraints of SBIAA.

Existing Procedures Not Followed for Purchase of Major Aviation Equipment

At least five sections of the purchasing policy could have been utilized for the purchase of major aviation equipment including (1) Construction Contracts; (2) Formal Contracts; (3) Purchase Authorization Levels; (4) Open Market Purchases; and (5) Negotiated Purchases. According to the *Construction Contracts and Change Orders* section of the SBIAA/IVDA purchasing policy:

All construction contracts in excess of \$5,000 must meet the requirements of the Formal Contracts Section unless other procedures are permitted and/or required by the Federal or State Agency providing the project funding for the construction.

Whether or not SBIAA management considered the acquisition of major aviation equipment as part of a construction contract, it appears that the *Formal Contracts* section of the purchasing policy would apply. The *Formal Contracts* section states, “Formal Contracts will be used when purchasing supplies, materials and/or equipment of a value in excess of \$25,000.” The section describes procedures for a competitive bidding process and states that, “The Executive Director will sign such contracts on behalf of the IVDA or SBIAA.” Further, the *Purchase Authorization Levels* section requires stricter controls, stating that:

All contracts and purchase orders of \$25,000 and greater will be signed by the Co-Chair or President of the Agency involved and approved by the Executive Director and Chief Financial Officer.

Additionally, the *Open Market- Competitive Bids Required* section of the purchasing policy would have also required the use of a formal contract. The section states:

Open Market Competitive bids will be obtained when purchasing supplies, materials, equipment and/or contractual services under the following guidelines:

\$5,000 - \$10,000: phone bids (at least 3 bids)

\$10,000-\$25,000: written bids (at least 3 bids)

Above \$25,000: formal contract- Board may require Formal RFQ/RFP

The contract will be awarded to the lowest qualified responsible bidder, or the Board or Commission may reject any and all bids.

SBIAA management ignored the procedural controls put in place by the Construction Contracts, Formal Contracts, Purchase Authorization Levels, and Open Market Purchase sections of the purchasing policy. The failure to adhere to these procedures likely contributed to the acquisition of major aviation equipment at higher cost and at a lower quality than could have otherwise been procured. Instead, according to comments made in interviews over the course of our audit fieldwork, SBIAA management followed the legal advice provided by the Authority’s legal counsel to procure major aviation equipment through the Terminal Development Project funding process. This process, as discussed in Section 3 of this report entitled *Construction Management*, as well as later in this section, does not provide adequate controls.

A fifth section of the purchasing policy, *Negotiated Purchases*, while lacking sufficiently written procedures, could have been utilized to better inform the Commission as well as SBIAA

management and staff prior to moving forward with Norton Development for the acquisition of major aviation equipment. This section's two clauses state:

- Negotiated purchases must be authorized by the Executive Director. This method will be used only when most advantageous to the Agency.
- A written report will be submitted to the Executive Director describing the circumstances and terms of the contract.

To our knowledge, no written report was submitted to the Interim Executive Director describing the circumstances and terms of the contract. Further, the Interim Executive Director did not refer to any such report in the July 3, 2007 staff report to the Commission and no contract was ever executed detailing the circumstances and terms for acquiring major aviation equipment.

Policies and Procedures are Weak, Outdated and Look Unofficial

The SBIAA/IVDA Purchasing Policy is inadequate for general procurement purposes and especially for high dollar value procurement such as for major aviation equipment. The purchasing policy is weak, outdated, and appears unofficial. The procedures contained in the *Negotiated Purchases* section of the purchasing policy are insufficient to provide a reasonable control over the use of SBIAA and IVDA funds. Specifically, the policy states that the Executive Director may authorize negotiated purchases, but only when “most advantageous to the Agency.” However, the policy does not define “most advantageous” and does not institute standards for showing that negotiated purchases are most advantageous to the Agency. While the section states that a written report should be submitted to the Executive Director describing the circumstances and terms of the contract, the policy does not stipulate what should be included in the written report and does not require the Executive Director to share that report with the Chief Financial Officer, Commission, or Board prior to authorization. Further, no dollar limit is set on negotiated purchases, which leaves SBIAA and IVDA with significant financial risk exposure.

Another procedural weakness of the purchasing policy is the lack of a clause addressing the purchase of used equipment, materials, or supplies. As previously mentioned in this section, life cycle cost analysis can be an effective method for assessing the complete costs and value of various purchasing options. The lack of a requirement to conduct life cycle cost analysis raises the financial risk exposure of SBIAA and IVDA when used equipment, supplies, and materials are purchased.

In addition to procedural weaknesses, the purchasing policy is outdated and appears unofficial. The SBIAA/IVDA Purchasing Policy was last updated nearly eight years ago on May 28, 2003. It is clear that SBIAA and IVDA have not utilized procedures for periodically reviewing and approving updates to this policy. It is very likely that developments over the last eight years in technology, software utilized, and in the structure and needs of the agencies has rendered some procedures outdated or insufficient for current use.

The purchasing policy has an unofficial appearance, which could contribute to an organizational attitude that it can be ignored. Specifically, all nine pages of the policy include edited changes that appear as “tracked changes” including old clauses that are crossed out and new language that is underlined. In some sections, these edit changes make the procedures difficult to read and

follow. Further, it is not apparent that the IVDA Board or the SBIAA Commission has approved this policy, which contributes to its non-official appearance and the likelihood of being ignored.

SBIAA Management Failed to Establish Sufficient Controls for Purchase of Aviation Equipment

SBIAA management has failed to construct a sufficient internal control structure for the acquisition of major aviation equipment for the Terminal Development Project. Specifically, SBIAA management has not set up basic controls such as the execution of a contract agreement and an internal monitoring system for verifying price, quantity, delivery, and condition of equipment. As previously mentioned, the Interim Executive Director did not execute a Sale and Purchase Agreement with Norton Development despite representations to the Commission that he would do so. The lack of an executed contract leaves SBIAA management and staff with little to no framework for verifying compliance with the agreement, including the quantity, cost, and condition of such equipment. The lack of an executed agreement also leaves SBIAA with substantially weakened legal standing if a dispute were to occur with Norton Development.

No Internal Monitoring Established for Acquisition of Aviation Equipment

SBIAA management never established a monitoring system for verifying the price, quantity, delivery, and condition of the used aviation equipment acquired from Norton Development. The lack of a basic internal monitoring system has left SBIAA exposed to the risk of being overcharged for equipment, receiving more or less equipment than agreed to, and receiving equipment in unacceptable condition.

During our fieldwork we were told that the Interim Executive Director and Assistant Director maintain a worksheet for verifying the delivery and cost of aviation equipment acquired from Norton Development. We were subsequently informed, however, that this worksheet was prepared as part of a special compliance review and not as part of an ongoing system for monitoring the acquisition of used aviation equipment. Further, a review of this document found that multiple used equipment expenditures are missing from the worksheet. The inclusion of these missing expenditures places the total amount expended above \$4,060,000, which is the “not to exceed” amount established by the Commission in Resolution 2007-05. Further, as previously mentioned, the anticipated purchase of an 11th jet bridge would raise the total amount expended on used equipment above \$4,466,000,⁹ the absolute maximum set by the Commission.

We were also provided with a list of expenditures for Terminal furnishings (primarily gate seating), which we were originally informed was part of the equipment verification process. This list of expenditures simply lists the check number, date, payee, and amount for each payment made for Terminal furnishings with a check mark next to each row. There is no evidence that the staff member who made the checks on the listing conducted any due diligence to ensure that SBIAA received the furnishings according to the correct price, quantity, and condition.

⁹ The absolute maximum is the sum of the not to exceed amount (\$4,060,000) plus a ten percent contingency (\$406,000).

Outside Control Fund is Not an Effective Method for Reducing Risk

As previously described in Section 2 of this report, entitled *Construction Management*, the external control fund set up for the Terminal Development and Fixed Based Operations construction projects is an inadequate control. The fund control process is set up with certain procedures including: (1) the requirement of three signatures (one from Norton Development, one from an IVDA Board Member, and one from SBIAA/IVDA staff); (2) documentation supporting the purchase; and (3) verification of available funds and final approval by First American Fund Control, Inc. Despite these procedures, the fund control process has several weaknesses including (a) the Chief Financial Officer is not required to sign off on fund request vouchers; (b) there is not always sufficient documentation to verify the appropriateness of the expenditure; and (c) the vouchers require a signature of a member of the Commission, even though the Commission members are not intimately familiar with the various budget allocations, line item authorizations or agreements.

Our findings, discussed previously in this section, that SBIAA ended up paying more for gate seating than originally anticipated illustrates the weaknesses of the fund control mechanism. Specifically, the vouchers for the gate seating included signatures from the Manager of Norton Development, the Assistant Director of SBIAA, and the President of the Commission as required by the Authority's agreement with the fund control agency. Additionally, the vouchers included attached contract information and/or invoices between Norton Development and PHC Industries (the company contracted to ship and refurbish the gate seating). Although these procedures were followed for the purchase of gate seating, SBIAA paid significantly more for the gate seating and received significantly less seating than anticipated.

The fund control mechanism has also not prevented SBIAA from exceeding the previously authorized not to exceed amount of \$4,060,000.

No Audits Have Been Conducted of Aviation Equipment Purchases

SBIAA management has not engaged an independent certified firm to conduct an audit of the procurement of used aviation equipment. Given the weak and seemingly ignored purchasing policy and weak or absent controls, an independent audit could have served as a valuable tool for identifying issues and risk exposure as well as recommending steps to reduce risk and/or resolve identified issues.

The one review that has been conducted¹⁰ covering costs associated with the Terminal Development Project was not an audit and its scope did not include the acquisition of used aviation equipment. As noted in the firm's report, they were "engaged to perform a *special compliance review* of the Terminal Building Construction Project" (emphasis added). The firm never refers to their report as an audit or their procedures as audit procedures. Further, the firm states in their report that they "were not engaged to, and did not conduct an audit, the objective of which would be the expression of an opinion, on the information described above" (the information referenced are the findings of the special compliance review). The report goes on to

¹⁰ A special compliance review was completed in February 2010 by Rogers, Anderson, Malody, and Scott, LLP.

state that, “Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.”

The firm’s report includes two references indicating that the scope of their review did not cover the purchase of specialized equipment installed in the Terminal building. The report states that certain costs, including specialized equipment installed in the Terminal Building, were not subject to their review. The report further states that the firm was “advised by the management of the IVDA/SBIAA that certain contracts did not lend themselves to competitive bidding including...certain equipment contracts where the specialized nature of the equipment made competitive bids inappropriate, or where only a single source of a particular item existed.” As the firm was engaged to review construction contracts including for the purpose of ensuring that competitive bids were received on all construction contracts, the exclusion of the specialized equipment contracts is an exception to their scope of review as directed by SBIAA management.

Conclusions

SBIAA management did not conduct proper due diligence prior to purchasing used major aviation equipment from Norton Development for the terminal building. SBIAA management did not assess its equipment needs, determine whether the used equipment was appropriate, or send staff to visually inspect the equipment prior to authorization by the Commission. Further, SBIAA management did not consider or analyze the long term costs of purchasing used equipment versus the alternative of purchasing new equipment prior to proceeding with the acquisition.

The Interim Executive Director never executed a Sale and Purchase Agreement with Norton Development despite multiple assertions to the Commission that he would do so and several references in the authorizing resolution indicating that such an agreement would be executed. In lieu of an executed contract, the terms of the agreement were later stated in a series of two letters from the Manager of Norton Development to the Interim Executive Director. The terms of these letters were substantially different from the representations made to the Commission by the Interim Executive Director.

SBIAA has insufficient controls, including policies, procedures, and audits for use when acquiring aviation equipment. SBIAA management has not set up an internal process for verifying price, quantity, or condition of the used aviation equipment that is acquired from Norton Development. Further, the fund control process is inadequate for ensuring that SBIAA receives a fair and accurate price for the used equipment. Additionally, there have been no audits conducted of the used aviation equipment.

Recommendations

The SBIAA Commission should:

- 3.1 Make a formal policy decision to only authorize contracts after they have been signed, on condition of Commission approval, so that it can properly review such contracts and to ensure that all major agreements are accompanied by signed and executed contracts.
- 3.2 Formally approve a purchasing policy that includes revisions to address the deficiencies identified in our review. In particular, eliminate the *Negotiated Purchases* section of the purchasing policy and require that all purchases above \$25,000 (or a different threshold deemed more appropriate by the Commission), regardless of purpose, require a formal contract to be approved by the Commission.
- 3.3 Set a regular schedule for reviewing, revising, and formally approving updates to the purchasing policy.
- 3.4 Engage the services of a reputable, independent auditing firm to examine the representations and warranties made by Norton Development management and SBIAA management in connection to the purchase of used aviation equipment as well as the amount actually spent on such equipment, and the estimated useful life and/or resale potential of the equipment.
- 3.5 Formally direct the Interim Executive Director and Assistant Director to cease from approving any further fund payments to Norton Development or any third parties with agreements to provide services in connection to the used aviation equipment, which was originally authorized on July 3, 2007.

Costs and Benefits

There would be no cost to implement these recommendations.

Taxpayers could save at least an additional \$134,689 if the Commission were to refuse to fund the 11th jet bridge currently being refurbished out of state. Taxpayers would also not have to pay for the developer and construction management fees as well as offloading and installation costs associated with this jet bridge.

4. Lawsuit Settlement

- On July 23, 2008, the San Bernardino International Airport Authority (SBIAA) entered into a lease agreement with Norton Aircraft Maintenance Services, Inc. (NAMS) for Hangar Bay No. 695. However, this hangar had previously been leased to another company pursuant to an agreement dated June 3, 2008, which was extended through August 23 on a day-to-day basis. This resulted in conflicting occupancy rights that led to a dispute between the tenants and a claim for damages against SBIAA by NAMS and SBD Aircraft Services, LLC (SBD). The latter company had contracted with NAMS for a Federal Aviation Administration (FAA) inspection and maintenance service on a Boeing 727 aircraft that it intended to lease to a third party. In response to the claim for damages, SBIAA agreed to a monetary settlement with the two companies amounting to approximately \$1 million.
- The Settlement and Mutual Release Agreement was executed by the three parties less than seven weeks after the lease between SBIAA and NAMS had been signed, and only 18 days after the claim for damages was submitted to the Airport by NAMS and SBD. SBIAA management did not compel either NAMS or SBD to submit documentation to objectively assess the appropriateness of the claim for damages or challenge the original amount of the claim in any meaningful way. Importantly, this settlement was amicably reached in a short time period, even though the lease agreement with NAMS included language intended to completely indemnify SBIAA from “consequential or punitive damages” in the event of default.
- Further, SBIAA did not require an independent appraisal of the aircraft, including the airframe and jet engines, which were pledged as collateral for the loan prior to disbursing funds. By failing to conduct an appraisal, SBIAA can not be assured that SBD will have financial resources that are sufficient to repay a loan amount of \$550,000 at the end of five years.
- The expedited nature of this agreement and the lack of due diligence by SBIAA to verify or determine the extent of damages, or independently obtain an opinion of value of the collateral pledged for the loan, make the appropriateness of the settlement questionable. The settlement resulted in substantial cost to the taxpayer, which may be greater if SBD defaults on the loan and the market value of the aircraft used as collateral is not sufficient to repay the balance of the debt owed to SBIAA.

On June 2, 2008, the San Bernardino International Airport Authority (SBIAA) entered into a lease agreement with Aeros Aeronautical Systems Corporation (Aeros), a tenant at the airport that was in the process of assembling a helium airship and preparing for the airship’s flight certification from the Federal Aviation Administration (FAA). This was a short-term lease for the period June 3, 2008 through June 12, 2008 for space in Hangar No. 695, being charged at a rate of \$400 per day (equivalent to approximately \$12,000 over a 30-day, or one month period).

However, because Aeros was unable to complete the assembly and obtain the airship certification from the FAA within the leasing period, the company entered into a second agreement with SBIAA that formally extended the lease through June 30, 2008. This second agreement included an option for a lease extension beyond June 30, “on a day-to-day basis at the discretion of the Authority” and established an increased rental rate of \$500 per day in the event the lease was extended. Aeros continued to have difficulty completing the airship assembly and obtaining the FAA certification within the period of this second lease, so the company remained in Hangar No. 695 into July 2008, with SBIAA’s tacit agreement.

On July 23, 2008, SBIAA entered into a lease agreement with Norton Aircraft Maintenance Services (NAMS) for space in Hangar No. 695 for a period of six months. At the time, NAMS wanted to lease the space to perform a FAA mandated inspection of a Boeing 727-227 aircraft owned by SBD. The lease required payment to the Authority of \$6,500 per month and included provisions for NAMS to terminate the lease in the event it declared SBIAA to be in default, by giving 10-days written notice to the Authority. As will be discussed below, the lease agreement with NAMS included language intended to completely indemnify SBIAA from “consequential or punitive damages” in the event of default.

During the period between approximately mid-June and the execution of the July 23 lease agreement with NAMS, it became clear to the lessees and SBIAA that there could be a problem with dual occupancy of the hangar once the lease with NAMS was executed. According to individuals interviewed for this audit, as well as a review of email documentation, a series of informal discussions occurred in an attempt to resolve the conflicting needs of both lessees. Alternatives that included subleases, dual occupancy of the hangar during the certification processes, and the movement of one or the other of the lessees to other space on the Airport property were all explored. However, SBIAA determined that these alternatives were unworkable and agreement between the parties could not be reached. During this period, escalating conflict arose between the lessees that allegedly included aggressive actions by NAMS personnel, such as premature movement of materials and equipment into the hangar, parking aircraft in front of hangar doors to prevent the return of the airship after completing a test flight, and threats against Aeros managers and staff. Aeros management also suspected that vandalism to the airship had occurred while it was being stored in the hangar.

On July 24, 2008 – a day after the NAMS lease was executed – SBIAA served Aeros with a 30-day notice to vacate the premises, consistent with California State unlawful detainer law.¹ Although Aeros was occupying the space on a day-to-day basis as of this date, the notice effectively extended the Aeros lease and occupancy period through August 23, 2008, which was one month into the lease period agreed to between SBIAA and NAMS.

Claim for Damages

NAMS asserted at the time that immediate occupancy of Hangar No. 695 was necessary in order to complete a Code of Federal Regulations Title 14, Section 145 “C-Check” on the Boeing 727-

¹ California Civil Code of Procedure Section 1161, et seq.

227 aircraft owned by SBD, which is an inspection of an aircraft to ensure airworthiness, prior to August 23, 2008. According to managers and the attorney for SBD, this inspection was necessary to fulfill a lease obligation “between SBD Aircraft Services and the Democratic National Committee for the lease of the Boeing 727, which was to have been used solely for the Democratic National Convention and the Obama for President Campaign.”²

At the time, the actual lease between SBD and the Democratic National Committee (DNC), allegedly through an intermediary aircraft leasing company named Unique Aviation Properties, Inc., was not produced by SBD due to assertions by the company that the contract document contained non-disclosure provisions. However, in a summary of the lease prepared by SBD’s attorney, it was stated that the contract required the Aircraft to be “delivered to Lessee at the Denver International Airport no later than August 23, 2008, with all maintenance checks current, including a fresh “C” check.”³ Because SBD was unable to occupy Hangar No. 695 at the San Bernardino International Airport, and no other space was considered to be available, the attorney asserted that this critical deliverable date would be missed and that SBD would suffer monetary losses as a result of an inability to complete FAA mandated inspections on schedule.

On August 22, 2008, a claim was submitted to SBIAA by NAMS and SBD, which alleged “wrongful conduct by the San Bernardino Airport Authority („SBIAA”) which induced (by negligent and/or intentional misrepresentation or concealment of material facts) NAMS to enter into that certain Hangar Lease entered into on July 23, 2008 between SBIAA, as „Lessor” and NAMS, as „Lessee” . . . Such negligence and/or intentional misrepresentation were also made to and/or concealed from SBD. With SBIAA’s knowledge, SBD also relied on SBIAA’s misrepresentation and/or concealment, which resulted in SBD losing the benefit of a separate aircraft lease it entered into with the Democratic National Party („DNP”) for the use of a B-727 aircraft.”⁴ Less than three weeks later, on September 9, 2008, SBIAA entered into a Settlement and Mutual Release Agreement with NAMS and SBD to settle the dispute.⁵

The table below shows the days that elapsed between execution of the hangar lease, the submittal of the claim for damages and the execution of the Settlement Agreement. As illustrated, the time period that elapsed between these key events was very short. The settlement was negotiated and agreed upon within 48 days after the date the hangar lease was first executed and only 18 days after the date the claim for damages was submitted to SBIAA management. During this period, the settlement agreement was reportedly approved by the SBIAA Commission.⁶

² August 26, 2008, email from Zane Gresham, SBD legal counsel, to Tim Sabo, SBIAA legal counsel, transmitting summary of aircraft lease agreement.

³ Undated *Summary of Lease of Aircraft for Obama Campaign*, Item 12, transmitted via email from Zane Gresham, SBD legal counsel to Tim Sabo, SBIAA legal counsel, transmitted to SBIAA legal counsel on August 26, 2008

⁴ August 22, 2008, *Claims Against San Bernardino International Airport Authority*

⁵ October 13, 2008, *Settlement and Mutual Release Agreement*

⁶ Assertion made by Donald Rogers, SBIAA Interim Executive Director. Evidence of Board action not provided.

Table 4.1**Days Elapsed Between the NAMS Hangar Lease, the Claim for Damages and the Settlement Agreement Between SBIAA, NAMS and SBD**

	Hangar Lease	Claim for Damages	Settlement Agreement	Days Elapsed	
				From Lease	From Claim
Date of Action	7/23/2008	8/22/2008	9/9/2008	48	18

Source: Lease for Hangar No. 695 between SBIAA and NAMS, Claim for Damages submitted to SBIAA by NAMS and SBD, and *Settlement and Mutual Release Agreement*

A more complete timeline illustrating the relationship between each of the key events described previously is provided as Exhibit 4.1 on the next page.

Monetary Settlement

The claim for damages stated that, “NAMS seeks damages of not less than Seven Hundred Fifty Thousand Dollars (\$750,000.00) for SBIAA’s misrepresentation and concealment and other wrongful acts, as well as consequential and incidental damages, including out-of-pocket expenses and attorney fees.” Similarly stated, SBD was seeking “damages of not less than One Million Dollars (\$1,000,000.00) for SBIAA’s misrepresentation and concealment and other wrongful acts, as well as consequential and incidental damages, including out-of-pocket expenses and attorney fees.” Combined, these two companies were demanding a minimum of \$1.75 million in compensation as a result of NAMS inability to use the hangar when promised and the subsequent cancellation of contracts with each other and between SBD and Unique Aviation Properties, Inc.

The Mutual Release and Settlement Agreement was for a lower settlement amount. However, according to the executed document, NAMS and SBD received combined monetary benefits that amounted to approximately \$1 million, as shown in the table, below.

Table 4.2**Components of the Settlement Agreement Between SBIAA, NAMS and SBD**

Terms of Settlement and Mutual Release	NAMS	SBD	TOTAL
Forgiveness of Insurance Loan Balance*	\$ 125,000	\$ -	\$ 125,000
Forgiveness of Hangar 763 Rent	-	315,000	315,000
Collateralized Aircraft Rehabilitation Loan	**	**	550,000
TOTAL	\$ 125,000	\$ 315,000	\$ 990,000

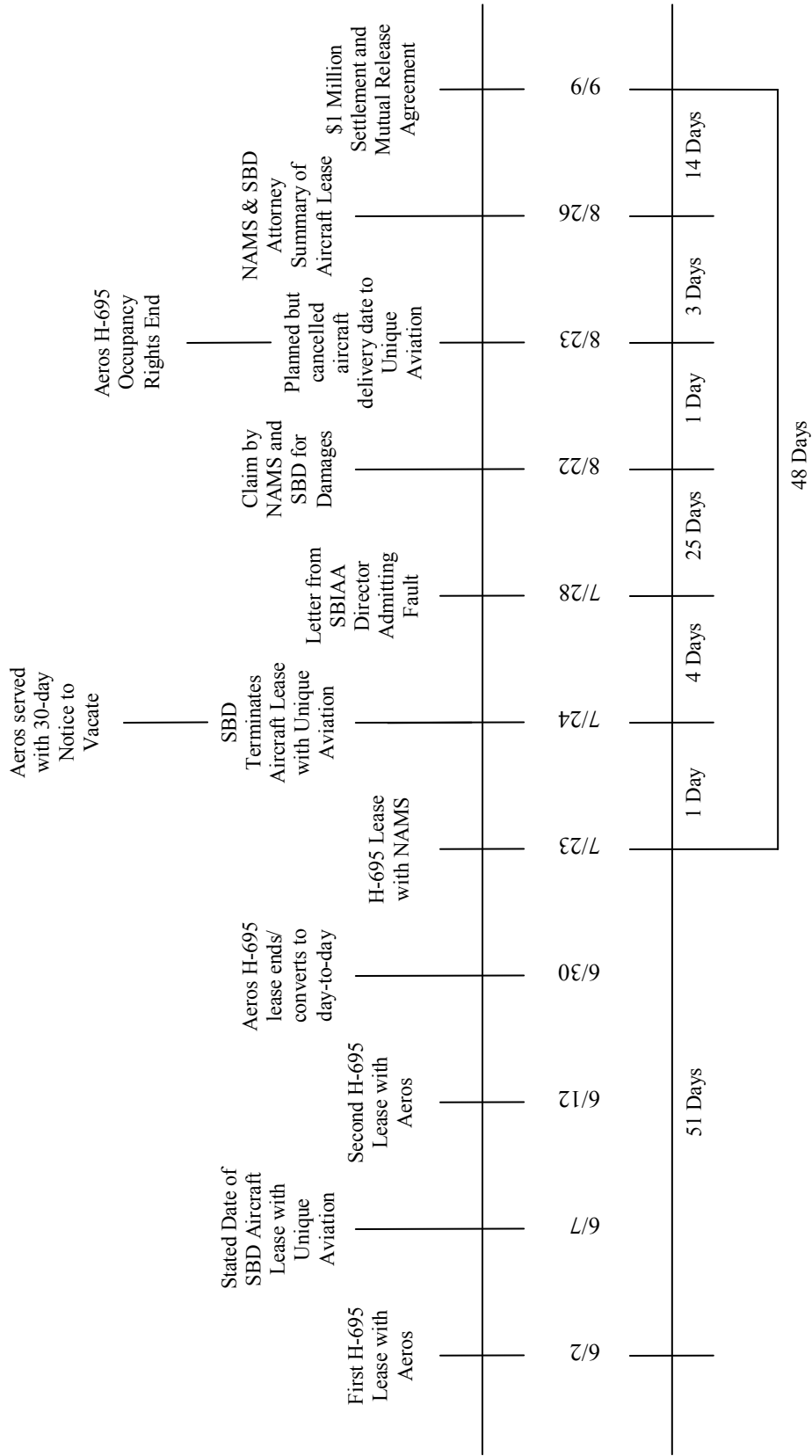
* Estimate based on original loan value of \$155,000, less a \$30,000 payment.

** Loan made to both companies "jointly and severally".

Source: *Settlement and Mutual Release Agreement*

Exhibit 4.1

2008 Hangar No. 695 Dispute and Resolution Timeline



As shown in Table 4.2, NAMS received direct monetary compensation of approximately \$125,000, which was provided by SBIAA by forgiving the balance due on an insurance loan provided to the company. The original loan amount had been for \$155,000, with a net amount remaining after NAMS made a payment of \$30,000 prior to the dispute. SBD received direct monetary compensation of \$315,000, which was provided by SBIAA by crediting rent due from SBD for Hangar No. 763 for the months of January, February and March of 2009. The total compensation received by these two companies from loan forgiveness and rent credits was approximately \$440,000.

Collateralized Aircraft Rehabilitation Loan

The final component of the settlement was agreement by SBIAA to loan the two companies \$550,000 for “Aircraft Rehabilitation.” The loan was to be repaid at the end of a five year term, accruing interest at the rate of 5% per annum. It was collateralized with a Boeing 727-227 airframe and three jet engines.

Under the terms of the Mutual Release and Settlement Agreement, the loan balance becomes due and payable with the sale of the airframe or engines, or is to be accelerated in the event the aircraft is leased, with SBIAA receiving 50% of the lease revenue as payment on the loan. However, the agreement also states that, “SBD, Inc. shall have no obligation to repay the . . . Loan except from the proceeds received upon a sale or lease of the Airframe, the 727 Aircraft and the three (3) jet engines and upon any foreclosure of the collateral by SBIAA.”⁷ In other words, based on the Settlement Agreement, repayment of the loan appears to be entirely dependent on the ability of SBD to lease or sell the aircraft for an amount sufficient to pay the principal and interest due at the end of the five year term.

Lack of Due Diligence

It is clear from the record that the decision to settle with the claimants in this matter was expedited by SBIAA. Apparently, in the Interim Executive Director’s judgment, the alleged errors that led to double occupancy of the hangar had resulted in the inability of the lessees to complete the work required to fulfill contractual obligations they had with each other and with the DNC, through Unique Aviation Properties, Inc. In a July 28, 2008 letter from the Interim Executive Director to a representative of the two companies, he stated:

SBIAA acknowledges that, contrary to its representations to NAMS and SBD, on which both of them relied . . . SBIAA was unable to deliver the leased space in Building No. 695 until after August 23, 2008. SBIAA also recognizes that this prevents SBD’s performance of the lease that was entered into by SBD in reliance on the SBIAA representation. . . . The actions of this other tenant to intentionally violate the terms of the short-term lease agreement have precluded your use of Building No. 695 for modifications and maintenance to the B-727 aircraft in accordance with the previously executed agreement with the DNP. It is equally unfortunate that SBD was forced to terminate the agreement for the use of the B-727 aircraft and NAMS to furlough 24 maintenance employees specifically hired by NAMS for this assignment. . . . SBIAA will meet all of its legal obligations, as they may be determined.

⁷ October 13, 2008, *Settlement and Mutual Release Agreement*

With these statements, the Interim Executive Director was essentially admitting responsibility for misleading NAMS and SBD, which he accepted had resulted in the need for NAMS to furlough employees and the inability of SBD to fulfill its contractual obligations to the Democratic National Party through Unique Aviation Properties, Inc. With these admissions, the Interim Executive Director also committed to have SBIAA meet “all of its legal obligations, as they may be determined”, suggesting a willingness to negotiate and agree to a settlement.

Further, it is important to note that this letter admitting responsibility was dated only five days after the date the lease was executed with NAMS and appears to address most of the key points included in the claim for damages that would be submitted by the claimants’ attorney approximately 25 days later. This fast turnaround occurred during a period when the issue regarding double occupancy and possible remedies appear to have been under consideration by the parties, suggesting that a decision to settle the forthcoming claim had been made prior to exploring alternatives that may have reduced the Airport’s liability.

Table 4.3 on the next page compares the Interim Executive Director’s admissions, included in his July 28 letter, with the claimants’ points of argument included in their August 22 claim. Based on these and other observations described below, it is our opinion that the SBIAA did not conduct due diligence when determining its liability in this matter or the appropriateness of the settlement amount being requested by or offered to the claimants.

Opportunities to Resolve Conflicting Leases Dismissed as Unworkable

During this audit, interviews were conducted with SBIAA management, contractors and other individuals with direct knowledge of the circumstances surrounding this leasing dispute. According to several persons interviewed, various opportunities may have permitted the occupancy conflicts to be resolved during the overlapping period of the leases. These included the following:

- Hangar No. 695 space could possibly have been shared by Aeros and NAMS. According to various individuals, Hangar No. 695 had sufficient space to allow both companies to work in protected areas simultaneously and progress with their FAA certification processes on schedule. According to these individuals, discussions had taken place between Aeros and representatives of NAMS and SBD for a subleasing arrangement to allow Aeros work to continue, while allowing SBD to also occupy the space. However, these discussions reportedly stalled and SBIAA did not actively intervene.
- Aeros was preparing to vacate Hangar No. 695 as early as June 17, but resumed FAA certification activities when led to believe by representatives of NAMS and SBD that NAMS would be willing to share space in the hangar. Had clear direction been provided at that time, Aeros indicates it would have been willing to vacate the premises.
- Other hangar space at the airport possibly could have been made available to either Aeros or SBD. Suggestions were made to equip other hangars on an emergency basis, and at least one tenant at the Airport approached the parties with an offer to allow one of the two companies to occupy other space that he was leasing at the time.

Table 4.3
Comparison of Key Points Included in
Interim Executive Director’s July 28 Letter and Claimants’ August 22 Claim

Theme	July 28 Director Letter	August 22 Claim	Comments
SBIAA Misleads NAMS	SBIAA employee represented to NAMS that the space SBIAA leased to NAMS under the Hangar Lease would be available for occupancy on or before July 25, 2008. . . . NAMS entered into the Hangar Lease in reliance on SBIAA’s representations.	During negotiations of the Hangar Lease, SBIAA represented to NAMS that Hangar 695 would be available for occupancy on or before July 25, 2008. NAMS entered into the Hangar Lease in reliance on SBIAA’s representations.	Interviews with various parties with direct knowledge of the incidents and a review of email documentation indicates that as early as June 18, there was active communication between SBIAA, Aeros and SBD to arrange subleases to accommodate both Aeros and NAMS during the overlapping period.
SBIAA Actions Harm NAMS & SBD	Contrary to representations, SBIAA is unable to deliver the leased space in Building Number 695 until after August 23, 2008. SBIAA also recognizes that this prevents SBD’s performance of lease that was entered into by SBD in reliance on the SBIAA representations.	SBIAA assured NAMS that it would be able to provide such space to NAMS by July 25, 2008 so that work could be commenced on that date and completed by August 25, 2008. Due to SBIAA’s misrepresentation and concealment, on July 26, 2008, SBD had to terminate the Aircraft Lease, losing the revenue contemplated under such lease.	Interviews indicate that discussions between representatives of NAMS, SBD and Aeros occurred as early as June 16, and a June 18 letter from Aeros to SBD Aircraft Services (who was the purported lessee of Hangar 695 when the Aeros lease expired) confirmed discussions on the intent to share space. NAMS personnel allegedly began to take aggressive action to occupy Hangar 695 space by at least July 21. Email documentation indicates that as late as July 28, 2008, NAMS personnel were still trying to actively occupy Hangar 695.
Extent of Damages	It is unfortunate that SBD was forced to terminate this agreement for the use of the B-72/aircraft and NAMS to furlough 24 maintenance employees specifically hired by NAMS for this assignment.	This misrepresentation and concealment has caused severe monetary damages to both NAMS and SBD since NAMS is unable to procure space to service the Aircraft, and subsequently, SBD has been compelled to cancel the Aircraft Lease.	The actual lease with the DNC or documentation of payroll and other incidental cost for NAMS workers were never produced.
Agreement for Monetary Settlement	SBIAA will meet all of its legal obligations to NAMS and to SBD, as they may be determined.	By its claim, NAMS seeks damages of not less than \$750,000 By its claim, SBD seeks damages of not less than \$1,000,000.	Evidence of losses never validated or quantified.

Source: August 26, 2008 letter from the SBIAA Interim Executive Director to the representative of NAMS and SBD, and the Claim for Damages submitted to SBIAA by the NAMS and SBD legal counsel

NAMS Lease Agreement Indemnified SBIAA

Even if the basis for the claim was considered legitimate, SBIAA had included language in the lease agreement with NAMS that indemnified the Authority from any damages related to defaulting on the lease. Specifically, the July 23, 2008 lease stated the following:

9.04 (B) If NAMS declares the Authority to be in default of this Lease and the Authority fails to cure such default within the time periods provided in this Lease, NAMS shall have the right to terminate this Lease within ten (10) calendar days written notice to the Authority.

9.06 NAMS REMEDIES – If the Authority materially breaches its obligation under this Lease, the sole remedy of NAMS shall be the termination of this Lease and NAMS shall not be entitled to receive any compensation from the Authority. NAMS waives any claim for consequential or punitive damages as a result of any act of the Authority, the Interim Executive Director or their officers, employees, attorneys or agents.

With the Settlement and Mutual Release Agreement, the Authority dismissed these terms, making them null and void. Had the matter been fully litigated, it is likely that this language would have minimized or eliminated the Authority's liability to NAMS. Further, SBD's claim against SBIAA should rightfully have been directed toward NAMS, since SBD had no contractual relationship with SBIAA. NAMS would have been prohibited from seeking "consequential" damages from SBIAA for claims made against it by SBD.

Obfuscation of Contract Relationship Involving the DNC

Documentation produced for purposes of reaching a settlement, including the July 28 letter from the SBIAA Interim Executive Director, the claimant's August 22 claim for damages, the August 26 summary of the "agreement between SBD Aircraft Services and the Democratic National Party" prepared by the claimants' attorney, and the September 9, 2008 Settlement and Mutual Release Agreement, consistently reference a contractual relationship between SBD Aircraft Services and the Democratic National Committee (DNC). However, these assertions materially misrepresent the facts, since there is no evidence that a contractual relationship between SBD and the DNC ever existed.

The fact that there was no contract between SBD and the DNC was first suggested in the August 26 email communication from SBD's attorney to legal counsel for SBIAA, which summarized the aircraft leasing contract. In that communication, SBD's attorney stated that, "At the request of SBD Aircraft Services, I have reviewed the lease between SBD Aircraft Services and the Democratic National Committee for the lease of a Boeing 727, which was to have been used solely for the Democratic National Convention and the Obama for President Campaign". However, in the summary of that lease, the attorney stated that the Lessee was the "Democratic National Committee through Unique Aviation." (Emphasis added). This is the first acknowledgement of a party other than the DNC that was actually leasing the aircraft.

However, even this assertion that the aircraft was to be leased by the DNC through Unique Aviation Properties, Inc. appears to be a misrepresentation of the facts, since the statement made by the attorney is inconsistent with the actual aircraft lease agreement submitted to the Grand Jury at a later date. The aircraft lease agreement clearly identifies the Lessee as Unique Aviation Properties, Inc., and makes the statement:

Section 5(e) Lessor (SBD) acknowledges that Lessee (Unique Aviation Properties) **may consider leasing or donating** the use of the Aircraft to the Democratic National Committee or the Obama for President Campaign. (Emphasis added). . . .

Section 15. Representations and Warranties of Lessee . . . (m) Lessee plans to **donate** the use of the Aircraft to the Democratic national Committee and the Obama for President Campaign and the Aircraft will be used for no other purpose without the prior written approval of the Lessor. (Emphasis added).

While the contract references the DNC and the Obama campaign, by the use of the word “consider” in Section 5(e) there is a question whether a formal contractual relationship between Unique Aviation Properties, Inc. and the DNC ever existed. Further, Section 15(m) drops the reference to “leasing” the aircraft to the DNC altogether. An actual agreement between Unique Aviation Properties, Inc. and the DNC or Obama for President Campaign has never been produced; and, the agreement between SBD and Unique Aviation Properties, Inc., that was provided after the Grand Jury demanded a copy, is undated.⁸ Further, documentation obtained toward the end of this performance audit shows that Unique Aviation Properties is an investor in multiple Spencer affiliated companies, including SBD Properties, LLC (the FBO developer and lessee, discussed in other sections of this report). On the SBD Properties, LLC investment listing, it shows that Unique Aviation partners as an owner with SBD Aircraft Services, which was party to this claim. The financial linkage of these companies and the other factors, described above, make the legitimacy of the claim that there had been a contractual relationship with the DNC questionable, and raise doubts about whether SBD actually suffered any monetary loss as a result of having to default on its agreement with Unique Aviation Properties, Inc.

Despite being mentioned repeatedly in the aforementioned documents, the President of SBD⁹ stated during an interview on March 16, 2011, that the use of the aircraft was “never intended” for use by the Obama for President campaign. Yet these assertions were central to the claim for damages being sought by NAMS and SBD, since it was claimed that contractual obligations to deliver the aircraft to the DNC by August 23, 2008 could not be met due to delays in gaining access to Hangar no. 695. In addition, the term of the agreement with Unique Aviation Properties, Inc. corresponded roughly with the period of the presidential campaign.

Further, prior to the execution of the Settlement and Mutual Release Agreement, the contract between SBD and Unique Aviation Properties, Inc. was never produced by the claimants because the claimants stated that there was a confidentiality provision in the contract that prohibited disclosure. Although Section 16(a) requires the parties to “unconditionally” agree that all of the terms and conditions of the agreement be confidential, the parties could permit disclosure with “prior written consent.” This possibility was never mentioned to SBIAA by the claimants. Instead, SBIAA was required to assess the circumstances using an inaccurate representation of the agreement prepared by a third party.

⁸ The *Settlement and Mutual Release Agreement* states that “the Aircraft Lease was in full force and effect as of June 7, 2008, through and including on or about July 24, 2008.

⁹ Scot Spencer

Importantly, the lease agreement states that the “Lessor may terminate the Lease no later than thirty (30) days prior to the Commencement Date, without penalty, if unforeseen maintenance issues on the Aircraft arise.” In fact, documentation that the lease was terminated by SBD with Unique Aviation Properties, Inc. on July 23, 2008 was submitted with a copy of the executed contract between SBD and Unique Aviation Properties, Inc. in response to the Grand Jury’s demand. This was 31 days before the contract commencement date of August 23 and, notably, was the same date the Hangar No. 695 lease agreement between NAMS and SBIAA was executed. The timing of these events raises questions of possible intent to create a condition that would permit a claim to move forward.

Actual Lessee Damages Never Quantified or Verified

The Settlement and Mutual Release Agreement claimed damages based on two primary premises: (1) that NAMS had incurred expenses for personnel and lost potential income by the cancellation of the contract to perform inspection and maintenance services on the aircraft; and, (2) that SBD had lost income by being unable to meet the contractual obligations it had with the DNC through Unique Aviation Properties. Neither of these assertions were objectively verified or quantified by SBIAA before agreeing to the settlement.

Market Value of Boeing 727 Aircraft Not Determined

The aircraft rehabilitation loan of \$550,000 was collateralized with a Boeing 727 (B-727) airframe and three jet engines. Depending on the condition of this equipment, market value can vary dramatically. The value of a fully refurbished 1973 B-727 aircraft configured for long-range executive transport can reportedly exceed several million dollars. However, the value of other equipment that may have a different configuration, has not been fully refurbished, has defective or non-operational components, and has not cleared FAA airworthiness certification processes can have a much lower value and may even be considered salvage. While Airport personnel used their own professional judgment regarding the value of the collateralized equipment, registered liens with the U.S. Department of Transportation to prohibit sale or transfer of the equipment to another owner before settlement of the debt obligations, and required that the aircraft clear a Section 145 “C-Check” before all funds would be disbursed, no appraisal of the equipment was conducted in advance of accepting the equipment as collateral for the loan.

Reported Aircraft Value Possibly Inflated

A review of title records maintained by the FAA indicates that the aircraft value may be in question. Although the sales price for the original 2002 acquisition by KCP Leasing and Services was not recorded with the FAA, through June of 2005, the owner companies never had debt on the aircraft of more than \$125,000. The FAA title history is summarized on the next page.

As shown, the original purchase price of the aircraft was not shown on the bill of sale from American Airlines. However, debt secured by the aircraft never exceeded \$125,000 between October 2002 and July 2005, when it was owned by KCP Leasing Services (a company managed by Scot Spencer). In July 2005, the aircraft was sold by KCP Leasing Services to SBD Aircraft Services, LLC – both reportedly owned by some of the same investors and both managed by Scot Spencer – for \$1,000,000. As will be discussed below, the recorded value with the San

Bernardino County Assessor is only \$463,325. This clearly was not an arms length transaction and, given the age, model and history of the aircraft, it is highly probable that the sales transaction was inflated by the seller and the buyer.

Table 4.4

Title History on B-727-227 Used as Collateral

Date	Title History	Conveyor of Interest	Recipient of Interest	Amount	Notes
10/21/2002	Bill of Sale	American Airlines, Inc. (Signature Illegible)	KCP Leasing Services by G.A. Warde	Unstated	Debt Issuance of Only \$125,000
1/10/2004	Promissary Note	Convair Aviation Associates, Inc. (No Signature)	KCP Leasing Services by Scot Spencer	\$ 125,000	Recorded Collateral Debt Release not Recorded
6/17/2004	Promissory Note	Certified Aviation Services, Inc. (Signature not Required)	KCP Leasing Services by Scot Spencer	119,250	Recorded Collateral Debt Release on 4/6/2005
6/21/2005	Aircraft Security Agreement	KCP Leasing Services by Scot Spencer	Certified Aviation Services, Inc. (Signature not Required)	125,000	Recorded Collateral Debt Release not Recorded
7/10/2005	Bill of Sale	KCP Leasing Services by Scot Spencer	SBD Aircraft Services, LLC by Scot Spencer	1,000,000	Sales Transaction
9/9/2008	Conveyance of Collateral	SBD Aircraft Svcs., Inc. by Scot Spencer	SBIAA (No Signature)	550,000	Recorded Collateral Debt
9/18/2008	Bill of Sale	SBD Aircraft Services, LLC by Scot Spencer	SBD Aircraft Services, Inc. by Milford Harrison	\$ 1,000,000	Sales Transaction

Source: Documents filed with the FAA.

Contractors Property Taxes Are Delinquent and Evidence of Prior Lien Release Not Evident

Past History of Mechanics Liens Against KCP Leasing Services

In addition, since the aircraft was originally purchased by KCP Leasing Services and subsequently sold to SBD Aircraft Services, a number of liens have been filed. These are briefly described, below:

- May 22, 2003 – A \$20,000 mechanics lien was filed against KCP Leasing & Services, LLC by Aero Pro for non payment of charges for aircraft maintenance painting services. No evidence that the lien was released was evident in the FAA record.
- March 9, 2004 – A \$112,299 mechanics lien was filed against KCP Leasing & Services, LLC by Certified Aviation Services, Inc. for non payment of charges for aircraft maintenance services. A release on this lien was filed with the FAA on April 6, 2005.

Although we did not find evidence of any current liens outstanding on the aircraft against SBD Aircraft Services, there does not appear to have been any effort by SBIAA to fully research this question before accepting the aircraft as collateral. To the extent that preexisting liens may exist, the net value of the aircraft would be diminished.

Contractors' Property Taxes Are Delinquent

As part of this review, we also researched property tax records for NAMS and SBD to determine if payments were current or if there are any outstanding balances that have not been paid by the two contractors. Records from the San Bernardino County Tax Collector indicate that both companies are delinquent with their payments.

Notably, SBD has not paid property taxes for the aircraft that was intended for lease to Unique Aviation Properties, Inc., and which was offered as collateral for the \$550,000 loan. The delinquent amounts, plus penalties and interest, include \$9,002.15 that was delinquent 11/2/2009 and \$7,758.48 that was delinquent 11/1/2010, for total delinquencies of \$16,760.63. In addition, the Property Tax Roll Value for the aircraft, as of January 1, 2010, was \$463,325, which is less than the amount of the loan for which it was offered as collateral.

Total delinquent property taxes owed by the two companies equaled \$40,704.13 as of April 27, 2011, not including other aircraft owned by the company for which we did not have FAA Registry Numbers. Although tax liens are not recorded until five years after the delinquency date, the balances due plus penalties and interest, represent additional obligations of the companies that diminish their net worth.

The components of the property tax delinquencies are shown in Table 4.5, below.

Table 4.5

**Schedule of Delinquent Property Taxes Owed By
SBD and NAMS as of April 27, 2011**

Company	Type Tax Due	Delinquent	Amount	Subtotal
SBD Aircraft Services	Secured Property	12/10/10	\$ 6,885.53	
SBD Aircraft Services	Secured Property	04/11/11	6,915.51	
SBD Aircraft Services	Unsecured Property	06/30/10	7,052.34	
SBD Aircraft Services	Unsecured Aircraft*	11/02/09	9,002.15	
SBD Aircraft Services	Unsecured Aircraft*	11/01/10	7,758.48	
Subtotal				\$ 37,614.01
Norton Aircraft Maintenance	Unsecured Property	11/01/10	\$ 3,090.12	
Subtotal				\$ 3,090.12
Total Delinquent Taxes				\$ 40,704.13

*Delinquent taxes for the B-727 used as collateral for the \$550,000 loan, only. Status of tax payments on other aircraft owned by SBD not researched because information on the FAA Registry Numbers were not known at the time of this report.

Source: San Bernardino County Tax Collector records.

Possible Remedies

Because the Settlement and Mutual release Agreement is a binding document, there is little that SBIAA can do to remedy the consequences of the premature decision to settle the claim, unless the Authority can find material factual errors in the assertions made by the claimants. The *Settlement and Mutual Release Agreement* states, “in the event any representation and warranties are later proven to be false or untrue to the detriment of SBIAA, this settlement agreement shall be null and void only as to SBIAA’s financial obligations, and NAMS shall immediately repay the Insurance Loan; and SBD shall immediately repay the three (3) months rent credit for Hangar

No. 763 and the remaining unpaid principal balance of the Temporary Secured Loan, plus accrued and unpaid interest thereon.” Should any of the assertions and warranties made by NAMS or SBD be found to be false or untrue, SBIAA should demand repayment as specified in the *Settlement and Mutual Release Agreement*.

Conclusions

The Settlement and Mutual Release Agreement was executed less than seven weeks after the lease between SBIAA and NAMS had been signed, and only 18 days after the claim for damages was submitted to the Airport by NAMS and SBD. SBIAA management did not compel either NAMS or SBD to submit documentation to objectively assess the appropriateness of the claim for damages or challenge the original amount of the claim in any meaningful way. Importantly, this settlement was amicably reached in a short time period, even though the lease agreement with NAMS included language intended to completely indemnify SBIAA from “consequential or punitive damages” in the event of default.

Further, SBIAA did not require an independent appraisal of the aircraft, including the airframe and jet engines, which were pledged as collateral for the loan prior to disbursing funds. By failing to conduct an appraisal, SBIAA can not be assured that SBD will have financial resources that are sufficient to repay the loan amount of \$550,000.

At the very least, the expedited nature of this agreement and the lack of due diligence by SBIAA to verify the existence or extent of damages, or independently obtain an opinion of value of the collateral pledged for the loan, make the appropriateness of the settlement questionable. In addition, the settlement resulted in substantial cost to the taxpayer, which may be greater if SBD defaults on the loan and the market value of the aircraft used as collateral is not sufficient to repay the balance of the debt owed to SBIAA.

Recommendations

The SBIAA Board of Commissioners should:

- 4.1. Engage the services of a reputable, independent auditing firm to examine the representations and warranties made by NAMS and SBD management in connection with the *Settlement and Mutual Release Agreement* and, if found to be false or untrue, demand immediate repayment of the Insurance Loan, Rent Credit and Temporary Aircraft Rehabilitation Loan balance.

Costs and Benefits

If the representations made by NAMS and SBD are found to be false or untrue, taxpayers would be reimbursed the cost of the *Settlement and Mutual Release Agreement*, amounting to \$440,000 in loan forgiveness and rent credits, and would receive immediate repayment of the balance due on the \$550,000 loan to NAMS and SBD.

5. Contractor Relations

- San Bernardino International Airport Authority (SBIAA) has entered into multiple contracts with companies managed by a single individual, Scot Spencer. Mr. Spencer is a convicted felon who served time for bankruptcy fraud in a federal penitentiary and, in a separate matter stemming from businesses he managed at San Bernardino International Airport, was ordered by the U.S. Department of Transportation (DOT) to “permanently cease and desist from further marketing or other involvement in air transportation operations so that he is banned from the aviation industry.” Mr. Spencer was ordered to pay civil penalties of \$1.0 million, which remain unpaid.
- Mr. Spencer’s history at SBIAA began in 2003 as a manager of KCP Leasing & Services, LLC, which was leasing space for the storage of Boeing 727 aircraft. Over the years, his involvement with SBIAA has grown, until Norton Development Company, LLC and SBD Properties, LLC (SBD) – two other companies that he manages – were granted development contracts to construct a new Terminal and a Fixed Base Operator (FBO) facility at the airport. The initial combined cost estimate for these two projects was about \$43 million, but through January 2011, SBIAA had spent over \$125 million on the projects. Companies affiliated with Mr. Spencer received payments of \$7.4 million in developer fees and reimbursement of nearly all of their costs through that date.
- As the development projects progressed, Mr. Spencer’s companies were given responsibility for major aspects of airport operations. After approaching the Interim Executive Director with an informal proposal, Mr. Spencer was able to obtain agreement from a nationally recognized company to participate in FBO services at the airport. Mr. Spencer then gathered investors to open a franchise of that company, which he now manages, named *Million Air San Bernardino, LLC*. Subsequently, SBD was awarded a 25-year lease to provide FBO services and run the airport fuel farm through *Million Air San Bernardino, LLC*.
- SBIAA had also solicited proposals for a nationally recognized airport management company to operate the airport, but no responses were received. As an alternative, the Interim Executive Director negotiated a sole source contract with Mr. Spencer through San Bernardino Airport Management, LLC (SBAM), which Mr. Spencer formed for that purpose and now manages. Compensation for SBAM under a 25-year agreement with SBIAA guarantees payments of \$500,000 per year, reimbursement of most major operating costs, and the receipt of 50% of net operating income. SBIAA absorbs all financial risk.
- The evolution of these sole source relationships between SBIAA and Mr. Spencer, and the growth in the involvement of the companies he manages, raises serious questions. Further, Mr. Spencer’s activities at SBIAA are in direct violation of the DOT order, which states he should be “banned from the aviation industry.” These matters should be seriously considered by the SBIAA Board when contemplating proposals to expand Mr. Spencer’s influence at the Airport.

Throughout this report, we have commented on various airport development and operations topics that have involved companies managed by a single individual, Scot Spencer, who began activities at the San Bernardino International Airport in 2002. At the time, he had entered into a lease agreement for the storage of several Boeing 727-200 aircraft through a company named Ascend Aviation, LLC. As discussed in this report, this role as a lessee gradually evolved until, in 2009, one of the companies he manages was granted a 25-year operating lease with SBIAA that provides him with significant control over all airport operations. As will be described in this section, the evolution of the sole source relationships between SBIAA and Mr. Spencer, and the growth in the involvement of the companies he manages, raises serious questions.

Record of Criminal Activity

Reportedly, Mr. Spencer has been involved with the aviation industry since he was a teenager. At the time, he was involved with two small companies in an ownership or management capacity: (1) *Southern Express*, based out of Texas; and, *Air One*, based out of Missouri. Both of these companies went bankrupt soon after formation. In addition, according to court records produced in connection with a later bankruptcy fraud conviction, (described below), he also has a criminal history that reaches back into at least the 1980s. A public records search indicates that in 1988 Mr. Spencer was convicted of knowingly writing bad checks in the State of Florida; and, as of June 2010, he had at least 21 civil judgments against him in New York, Florida and New Jersey, which included federal, state and local tax liens. Although related, the following narrative does not focus on these events but, instead, discusses his involvement with the airline industry and related criminal activity since approximately 1990.

Braniff Airline Bankruptcy and the Formation of “Braniff III” by BNAir

In 1988 an investment company purchased Braniff Airlines, which had ceased to operate in 1982 and had filed for bankruptcy. A second company was then formed in 1988 and named Braniff, Inc., and is referred to in legal documents as “Braniff II.” This second company ceased operations and filed for bankruptcy in 1989. In 1990, the same group of investors that had formed Braniff II formed a third company named BNAir and purchased the Braniff name from the Braniff II bankruptcy estate. This third company became known as “Braniff III.” Mr. Spencer, in his early 20s at the time, had been involved in the Braniff II purchase and bankruptcy, and was later named the President of BNAir, or Braniff III.

To operate the airline, BNAir was required to obtain and applied for a “certificate of public convenience and necessity” from the United States Department of Transportation (DOT). However, as part of the certification process, DOT concluded that it had significant concerns and objected to BNAir’s proposal to provide airline passenger service. According to court documents, the “DOT expressed its concern about Spencer’s role with the company, *citing his lengthy criminal history and poor performance record with Braniff II.*” (Emphasis added).¹ Therefore, the certificate was denied and not issued to BNAir and, consequently, the airline could not operate.

¹ Findlaw for Legal Professionals, No. 1031, Docket 96-1460, United States Court of Appeals, Second Circuit, *United States v. Spencer*

Faced with this obstacle, in 1991, BNAir then attempted to obtain the required certification by purchasing Emerald Air, Inc., “an airline in bankruptcy that already possessed the necessary certificate.” Despite continued concerns, the DOT reissued the Emerald Air certificate in that year, but only after obtaining sworn affidavits from the BNAir investors and Mr. Spencer that Mr. Spencer “would hold no position and have no involvement in Braniff” III. The DOT received those sworn affidavits in May 1991.²

In 1992, BNAir ceased operations and declared bankruptcy and, in 1994, Mr. Spencer and one of the investors were indicted on four counts related to fraudulent activities surrounding the Braniff bankruptcy. Mr. Spencer was convicted on two of the counts. Court documents noted that Mr. Spencer had remained “heavily involved” in the operations of Braniff III, despite the DOT condition of certification through Emerald Air and Mr. Spencer’s affidavit swearing that he would have no involvement.³ As stated in Court records, “It was Spencer’s effort to receive compensation surreptitiously for his services to Braniff that led to his convictions . . .” According to the Court, this had been accomplished with a “scheme . . . to launder Braniff’s payments to him and thereby conceal them from the bankruptcy court and Braniff’s creditors . . .”⁴ through a third party advertising contractor.

Mr. Spencer was sentenced to a term of 51 months in prison and three years of supervised release. He appealed the conviction and sentencing in 1997, but the appeals court affirmed both and he was required to serve his sentence. He was reportedly released from prison in 2002.⁵

DOT Administrative Law Matter – Republic Air Travel

In the early 1990s, Mr. Spencer was also involved with a company named Republic Air Travel, LLC, which had a contract with a second company to act as “exclusive retail travel agent . . . to market, promote and sell tickets to the public for transportation” on charter flights. In 1992, Mr. Spencer was serving as the Director and Vice President of Republic Air Travel, but in December of that year, he removed himself from those positions and began working for the company as a “consultant.” Despite this change in his official relationship with the company, Mr. Spencer was found by DOT investigators to be involved in “most if not all of the company’s significant financial decisions” and “many significant operational decisions of the company.”

During this period, DOT investigators found that Republic Air Travel sold non-refundable airline tickets to customers on flights that were known to be overbooked. The company also advertised low fares in major newspapers that were never honored. It was the DOT investigator’s conclusion that, pursuant to Mr. Spencer’s control, Republic Air Travel acted as a Public Charter Operator, acted as a ticket agent, engaged in deceptive advertising practices, engaged in

² Ibid

³ Ibid. On appeal, Mr. Spencer conceded that he “acted openly and flagrantly on behalf of Braniff”.

⁴ Ibid

⁵ The year of Mr. Spencer’s release is uncertain since information on the release date was principally obtained from newspaper accounts and professional journals. It is clear that by 2002, he had been released and resumed his involvement in the aviation industry.

unauthorized “oversales” of charter flights, and failed to provide timely ticket refunds to customers, all in violation of the law and DOT regulations.

This matter was not concluded prior to the criminal judgment involving the Braniff bankruptcy, discussed previously, and so the complaint went into suspense. However, knowing the matter was still pending in 2006, Mr. Spencer filed a motion for a Protective Order on the Republic Air Travel complaint and requested that the complaint be joined with a subsequent DOT administrative law conviction for purposes of negotiating a settlement. As of June 26, 2009, DOT reported that Mr. Spencer had not pursued his request for a settlement conference by filing required documentation on the Republic Air Travel matter, and there is no other evidence that the Republic Air Travel matter has progressed beyond the 2006 filing.⁶

DOT Administrative Law Matter – Ascend Aviation Group

After being released from prison in connection with the Braniff bankruptcy, and with the Republic Air Travel matter still pending before the DOT, Mr. Spencer once again became involved in the aviation industry by assisting investors with the formation of KCP Leasing & Services, LLC and acquiring 13 older Boeing 727-200A aircraft that had been retired by American Airlines after the terrorist attacks of September 11, 2001. Mr. Spencer reports that he was tasked by the investors with identifying an airport where the planes could be stored and refurbished for leasing and, in 2003 he entered into a ground lease with SBIAA for the storage of the planes at San Bernardino International Airport.

Working with the investors, Mr. Spencer also formed two additional companies: (1) Ascend Aviation Group, LLC; and, (2) Ascend Aviation Marketing and Sales, LLC. Because none of these companies had Federal Aviation Administration (FAA) certificates to operate an airline, Ascend Aviation contracted with Ryan International Airlines, Inc., out of Kansas to fly the aircraft owned by KCP Leasing & Services on flights being booked through Ascend Aviation Marketing and Sales. According to news reports published at the time, these services were being provided to major entertainment industry executives and celebrities, including television networks and major league sports teams.

During this short, initial period after being released from prison, Mr. Spencer had therefore been instrumental in the formation of three aviation companies, purchasing aircraft and managing charter air services. However, he immediately began to default on his obligations to both his customers and vendors. For example, according to news reports, (1) Blue’s Aviation Services, which operated the fuel farm at San Bernardino International Airport at that time, reportedly seized one of the aircraft owned by KCP Leasing & Services to obtain compensation for unpaid jet fuel bills; (2) Altitude Aviation sued Ascend Aviation for the refund of \$71,000 that was paid for a cancelled charter flight that had been scheduled for CBS executives and celebrities; and, (3) the Los Angeles Dodgers sued Ascend Aviation for \$220,000 for failing to deliver scheduled charter flights for the team.⁷

⁶ Docket DOT-OST-1995-272 (Enforcement Proceeding Status Report), *U.S. Department of Transportation Office of Hearings Washington D.C. in the matter of Republic Air Travel and Scot Spencer*

⁷ Saturday, August 13, 2005, *Inland airport on a limb with deal*, San Bernardino Press-Enterprise

In 2004, the U.S. Department of Transportation began regulation enforcement proceedings against Ascend Aviation Group, Ascend Marketing and Sales, KCP Leasing & Services and Scot Spencer, as an individual and the manager of all three companies. In 2005, Mr. Spencer was found guilty of (1) operating as an indirect air carrier without the requisite authority from the DOT; and, (2) engaging in unfair and deceptive practices and unfair method of competition. He was ordered to pay a fine of \$1.0 million and “to permanently cease and desist from further marketing *or other involvement in air transportation operations so that he is banned from the aviation industry . . .*” (Emphasis added).⁸ Although Mr. Spencer has appealed the judgment and sentence, with a request to join the unresolved Republic Air Travel matter as part of a negotiated revised settlement, neither the judgment nor the sentence has been modified as of the writing of this report. In addition, Mr. Spencer has not paid the \$1.0 million civil penalty associated with his conviction.

Evolution of Contract Relationships with SBIAA

Through Ascend Aviation, Mr. Spencer entered into a lease agreement with SBIAA in 2003 for the storage of 13 aircraft owned by KCP Leasing & Services, LLC. Mr. Spencer stated during interviews that he was looking for a location in a dry climate to store the aircraft, but was having difficulty finding such space in Arizona or Nevada – where many aircraft are stored - due to the high demand for such space following the terrorist attacks of September 11, 2001 and the subsequent downsizing of the airlines. It was during this period that KCP Leasing and Services and Ascend Aviation ran into the difficulties with the DOT that were described previously.

In early 2004, the lease was transferred to KCP Leasing & Services. At approximately the same time, the Interim Executive Director became aware of Mr. Spencer’s criminal history and took actions that suggested he had concerns, including reporting information he had learned to members of the San Bernardino County Board of Supervisors and other officials.

The Interim Executive Director research provided information on the Braniff bankruptcy fraud. However, at the time, no information regarding the difficulties with the DOT were reported and, presumably, had not been found. The Interim Executive Director reported:

Prior to learning of this prior criminal activity, SBIA entered into a month-to-month lease with KCP Leasing, LLC. . . . The Airport has not entered into any long term commitments. We can terminate the lease upon 30 day notice without cause.

Nevertheless, I felt it important to notify each of you of this new information. We will carefully watch to see that all terms of the Lease are complied with and also try to learn more about the background of Mr. Spencer.

I do not recommend any immediate action, but felt it important to advise each of you of the facts and assure you that we will watch very carefully any subsequent dealings with Mr. Spencer or his companies. Again, we have no long-term commitments.

It is clear from this communication that the Interim Executive Director was concerned about what he had learned, communicated his concerns to responsible officials and reported on the

⁸ Docket OST 2004-17486 (Enforcement Proceeding), *U.S. Department of Transportation Office of Hearings Washington D.C. in the matter of Ascend Aviation Group, LLC, et al*

ability of SBIAA to terminate its relationship with Mr. Spencer with merely 30-days notice, if necessary. He also reported that Mr. Spencer's companies were approximately \$100,000 behind in their rental payments for the leased space at the time.

As discussed previously, in 2005 Mr. Spencer was convicted of violations of Department of Transportation regulations through these companies, fined \$1.0 million and banned from the aviation industry. Although the Interim Executive Director indicated in his communication with officials that SBIAA would "watch very carefully" and assured these same officials that the airport's relationship with Mr. Spencer could be terminated with short notice, the airport's relationship with Mr. Spencer grew substantially in the ensuing years.

During interviews with the Interim Executive Director, he was asked why he chose to continue his business relationship with Mr. Spencer after learning of the bankruptcy fraud conviction. He responded that he made that decision after conducting further research on Mr. Spencer's background, including the DOT Administrative Hearing decision, and accepting Mr. Spencer's representation of the circumstances that led to the convictions. He accepted Mr. Spencer's assertion that his bankruptcy fraud conviction merely resulted from a decision to defend himself against the government's charges and a failure to negotiate a more favorable settlement with the prosecution. He also stated that after speaking with DOT investigators, he accepted Mr. Spencer's assertion that the administrative law conviction occurred mostly because, by failing to appear as ordered, the Administrative Law judge merely entered a default judgment against Mr. Spencer. The Interim Executive Director also suggested to the audit team that because the DOT matter was on appeal, the judgment and order could still be modified. The Interim Executive Director also stated that he had inquired with DOT officials regarding the intent of the order that "banned" Mr. Spencer from the "aviation industry" and that he was advised that "as long as he does not sell airline tickets," Mr. Spencer could continue to be involved in other aviation activities. This interpretation runs counter to a plain language understanding of the judge's order and is not documented in any fashion. We therefore reject the Interim Executive Director's interpretation and assertion regarding the court's intent.

Subsequent to the Interim Executive Director's inquiries, the record shows that Mr. Spencer's involvement with SBIAA grew to the point where he has inordinately influenced all major development decisions, resulting in his companies being awarded contracts for most major development projects at the airport. Further, Mr. Spencer's companies now hold 25-year leases to operate the airport, provide Fixed Base Operator (FBO) services and provide aircraft fueling services. A close review of the record demonstrates that there are several instances when Mr. Spencer and his companies have been granted favorable interpretations of contract language, had rental obligations waived, and received favorable resolutions to disputed matters after direct negotiations with the Interim Executive Director. The growth in Mr. Spencer's responsibilities and influence over airport operations is described more fully, below.

Migration of Hangar Leases to Major Construction and Management Control

SBD Aircraft Services, LLC

In 2005, Mr. Spencer paid the outstanding \$100,000 in delinquent rent to the airport and was awarded a new lease for Hangar No. 763 under a newly formed company he called SBD Aircraft Services, LLC (SBD Aircraft).⁹ This lease, executed August 1, 2005, was entered into for two quadrants of the hangar (Bay 3 and Bay 4) with an option to lease the other two bays, should a need arise. The agreement provided for a five year term, with three optional extensions for five years each, for a total potential term of 20 years. Any and all extensions would be at the option of SBD Aircraft. The lease permitted SBD Aircraft Services to operate: (1) an aircraft leasing and/or executive jet business; (2) a Part 145 maintenance, repair, and overhaul facility business either on its own or on a contract basis, for service of aircraft owned by SBD and third-party owned aircraft; (3) a spare parts acquisition and sales business; (4) administrative and support activities related to these businesses; (5) an aircraft leasing business; (6) cargo warehousing and flight activity; and, (7) other uses approved in writing by the Executive Director.

The lease with SBD Aircraft for Hangar No. 763 was amended three times following the initial execution in August 2005. All three amendments occurred during the initial five year term of the lease. The first amendment to the SBD Aircraft Lease for Hangar 763 was executed on April 12, 2007, about 20 months after the initial lease was signed. Among other seemingly minor changes, the first amendment increased the amount of space available for lease by SBD Aircraft, consisting of 11,046 square feet formerly occupied by Riley Super Sky Rocket, located in the northwest portion of Hangar 763. The first amendment also had a provision that, “on or before April 13, 2007, SBD [Aircraft Services] shall remit a payment in the amount of \$77,473 which represents payments of rent outstanding and due and payable to SBIAA.”

It is unclear when the second amendment to the SBD Aircraft Lease for Hangar 763 was executed. While Amendment 2 states that it is “made and entered into to be effective as of the 12th day of August, 2009,” Amendment 3 states that Amendment 2 was “effective as of July 1, 2009.” Nonetheless, Amendment 2 to the SBD Aircraft Lease is primarily an acknowledgement of a letter from SBD Aircraft dated June 29, 2007 stating SBD Aircraft’s desire to exercise its option to lease additional areas. Specifically, SBIAA approved SBD Aircraft’s leasing of Bay 1, Bay 2, and “certain portions of the First Floor of the East Annex.” SBIAA also approved the leasing of Bay 3 by Norton Aircraft Maintenance Services.

The third amendment to the SBD Aircraft Lease for Hangar 763 included four provisions. The first two provisions related to the abatement of three months of rent to SBD Aircraft for the months of April 2009, May 2009, and June 2009. SBD was also to abate rent to each sub lessee for the months of February 2009, March 2009, and April 2009. The third provision related to the granting of a \$150,000 rent credit to SBD Aircraft for the completion of improvements to the

⁹ SBD Aircraft Services, LLC is a Florida Limited Liability Company that was created on April 22, 2005. Scot Spencer and Milford Harrison are listed as managers on the registry provided by the Florida Secretary of State. No members are listed.

East Annex portion of Hangar 763. The fourth provision related to an additional \$15,000 rent credit granted for certain Heating Ventilation and Air Conditioning (HVAC) repairs that SBD Aircraft had undertaken in Hangar 763.

Norton Aircraft Maintenance Services, Inc.

Norton Aircraft Maintenance Services, Inc. (NAMS) is a Delaware Corporation that was created on January 22, 2008.¹⁰ NAMS became a subtenant of SBD Aircraft Services (now Norton Property Management, LLC) in 2008. According to the California Secretary of State, the current status of NAMS is “forfeited,” meaning that the business entity’s powers, rights and privileges have been suspended or forfeited in California by (1) the Franchise Tax Board for failure to file a return and/or failure to pay taxes, penalties, or interest and/or (2) the Secretary of State for failure to file the required Statement of Information and, if applicable, the required Statement by Common Interest Development Association.

According to Mr. Spencer, NAMS was created as the result of a “bailout/takeover” of a former subtenant, SoCal Precision, in December 2007. Mr. Spencer stated that SoCal Precision was having financial difficulties at the time and that he personally intervened “on Christmas Eve” of that year to secure investor contributions to ensure the “bailout/takeover.” Further, Mr. Spencer has stated that this “bailout/takeover” included the transfer of SoCal Precision’s FAA license to operate a Part 145 repair station to the new company, NAMS. Although Mr. Spencer has made multiple assertions that he has no role in the management or operations of NAMS, his relationship with the company is unclear. According to Mr. Spencer, it is “owned by some of the same investors” who own the companies that Mr. Spencer manages, and so he occasionally has responsibilities related to NAMS matters. Further, Mr. Spencer is commonly recognized by SBIAA representatives as a spokesperson for NAMS management, as evidenced during interviews, when no distinction was made by the interviewees, and from certain documents reviewed for this audit.¹¹

SBD Properties, LLC

Mr. Spencer created SBD Properties, LLC (SBD Properties), a Florida Limited Liability Corporation, on July 27, 2006. According to the Florida Department of State, Mr. Spencer and Milford Harrison are listed as managers of the company.

SBIAA awarded SBD Properties a sole source lease agreement for the development of an FBO building and for the establishment of a national FBO company to operate at San Bernardino International Airport. When the lease was approved in March 2007, SBIAA management estimated that the FBO building would cost approximately \$5 million to complete. As the project progressed, the scale and design of the FBO facilities grew, so that as of January 2011, approximately \$30 million in costs had been incurred with work and costs continuing to occur.

¹⁰ California Secretary of State business filing.

¹¹ July 28, 2008, Letter from Interim Executive Director, Don Rogers to Scot Spencer as the representative of NAMS and SBD Aircraft.

Of this amount, the companies managed by Mr. Spencer had received approximately \$2.7 million in developer fees and cost reimbursements.

The expansion in scope and cost of the FBO project included the construction of a new fuel farm, the construction of a multi-story customs facility, and the acquisition of fuel trucks and FBO equipment. In addition, as part of the FBO project, SBIAA financed a buyout of leaseholder interest and the acquisition of equipment of the former FBO company, Blue's Aviation, by SBD Properties, LLC at a cost of \$2.3 million.

Million Air San Bernardino, LLC, another company managed by Mr. Spencer, was created on July 3, 2008 to operate a franchise of Million Air Interlink, a national FBO company. According to Mr. Spencer, Million Air San Bernardino is a subsidiary of SBD Airport Services, LLC and is party to the San Bernardino Airport Management, LLC agreement with SBIAA for long term management and operations of San Bernardino International Airport.

Norton Development Company, LLC

As noted in detail in Section 2 of this report, Mr. Spencer created Norton Development Company, LLC (Norton Development) on May 23, 2007 in order to remodel and develop the San Bernardino International Airport Terminal Building. Norton Development was awarded a sole source lease and development agreement to construct the terminal building in May 2007 for an estimated initial cost of \$38 million. However, the scale and cost of the Terminal Development Project has increased substantially over time so that as of January 2011 SBIAA had expended over \$96 million with work and expenses continuing to occur. Of this amount, the companies managed by Mr. Spencer had received approximately \$4.7 million in developer fees and reimbursements of costs.

Terminal and FBO Equipment Acquisition

As noted in detail in Section 2 and 3 of this report, Mr. Spencer was given responsibility for acquiring major aviation equipment for the terminal building and for the FBO facility through Norton Development and SBD Properties respectively.

As described in Section 2, the original conceptual design for the terminal building did not require the use of expensive major aviation equipment, including jet bridges. However, after the building design had been revised, based on passenger traffic projections and air carrier specifications provided by Mr. Spencer, jet bridges were seen as a requirement. As described in Section 3, SBIAA management made a determination based on limited information and analysis to acquire used aviation equipment through Norton Development rather than engage in a competitive process for such equipment. Further, although the Interim Executive Director asserted to the Commission that a Purchase Agreement would be signed with Norton Development, no such action was taken and the acquisition was processed under the Interim Executive Director's general purchasing authority.

SBIAA also provided funding to SBD Properties for the lease and acquisition of equipment for FBO operations. Specifically, approximately \$2.3 million in SBIAA funds were spent on the acquisition of Blue's Aviation leasehold interest, including the purchase of used equipment to be leased to SBD Properties by SBIAA. Additional funds¹² were allocated for the purchase of supplementary equipment, including three fuel trucks.

Management of FBO and Airport Operations

After approaching the Interim Executive Director with an informal proposal, SBD Properties was able to obtain agreement from a nationally recognized company to participate in a contract to provide FBO services at the airport. To obtain a contract with SBIAA, Mr. Spencer gathered investors to open a franchise of that company, which he now manages, named Million Air San Bernardino, LLC. It was through this company that Mr. Spencer was awarded the long term FBO lease as well as a lease to operate the airport's fuel farm. Accordingly, the FBO Lease Agreement approved by the SBIAA Commission in March 2007 provided SBD Properties with a 25 year lease of the FBO facilities with two five year extensions for a total potential lease term of 35 years. The option to extend the term is at the discretion of SBD Properties.

Later, in December 2009, the SBIAA Commission approved the execution of an Airport Management and Development Agreement with AFCO/AvPorts San Bernardino, LLC through its affiliate San Bernardino Airport Management, LLC (SBAM) for certain airport management services. Both companies were formed and are managed by Scot Spencer. Further, the terms of the agreement are favorable to SBAM to the point where the contractor has taken on no financial risk. Specifically, compensation for SBAM under the 25-year agreement with SBIAA guarantees payment to SBAM of \$500,000 per year, reimbursement of most major operating costs, and payment of 50% of net operating income. In short, SBIAA absorbs all financial risk.

Relationship Concerns

The relationship that Mr. Spencer has cultivated with the Interim Executive Director and SBIAA management evolved over the years, and Mr. Spencer is now relied upon as a prominent advisor and key member of the management team at the Airport. Given Mr. Spencer's criminal history and the record of DOT administrative law rulings against him, some major concerns regarding these relationships should be considered by the SBIAA Board of Commissioners.

Spencer's Experience and Reputation

The Interim Executive Director has stated that Mr. Spencer provides significant benefit to SBIAA as a result of his extensive experience and number of contacts that he reportedly has in the commercial aviation industry. Yet, a close examination of the record shows that these perceptions may be poorly conceived.

¹² Our audit team was not able to determine the precise amount of funds that were used for the purchase of FBO equipment due to the lack of an inventory or clear reports to the Commission from SBIAA management.

There is no evidence that Mr. Spencer's experience ever extended to constructing or operating an international airport with commercial, freight and general aviation functions. Instead, his professional activities have involved numerous failed attempts to operate airline related businesses, each one of which ended in bankruptcy, a criminal conviction or violations of DOT administrative law. Mr. Spencer's professional reputation is questionable, given his background of criminal activity; the Braniff bankruptcy fraud matter; his poor relations with the DOT, including his ban from the aviation industry; and, general criticisms that he receives in aviation trade publications.¹³ His professional associations are questionable, since he has not shared a comprehensive list of investors in the many companies he forms and manages. Further, Mr. Spencer is most frequently associated with George Warde, a respected but elderly, retired airline executive who was admonished by the DOT and assessed civil monetary penalties resulting from his participation in the unlicensed operation of charter flights out of San Bernardino International Airport (i.e., the KCP Leasing & Services and Ascend Aviation matter).

Promises Not Kept

Mr. Spencer has made numerous promises that he would be able to attract major commercial air carriers to SBIA, which has been used as a rationale for expediting development projects and driving airport design attributes that have resulted in major additional costs to the taxpayers. As recently as March, 2011, assertions were made by both the Interim Executive Director and Mr. Spencer that an agreement with "major" regional or international airlines would be forthcoming "within six weeks," but that details of the agreement must be kept "confidential." These same promises were made just prior to initiating the fast-tracked Terminal Development Project, again in mid-2009 when the Grand Jury began its inquiries, and numerous times in-between. As of the writing of this report, no contracts with airlines have materialized and it appears that Mr. Spencer's promises have been baseless.

Contractual and Other Advantages Provided to Mr. Spencer

Collectively, the development and operating agreements entered into between SBIAA and Mr. Spencer's companies have been designed in a manner that results in SBIAA bearing all or most of the financial risk. On the Terminal Lease and Development contract, SBIAA reimburses all costs, including the developer's required insurance, legal costs and other expenses that would normally be borne directly by a contractor.

As mentioned previously, the Spencer-managed company, SBAM, receives minimum compensation of \$500,000 in operations and management fees, and reimbursement of most operating costs, and receives 50% of net income from operations. In years when there may be an operating loss, SBAM has no liability. The FBO development agreement was to be fully funded by SBD Properties and sold back to SBIAA at completion, and was presented as such by the Assistant Director. However, IVDA guaranteed the bank loan and reimbursed costs as they occurred, so that there was little or no out-of-pocket expense borne by SBD Properties.

¹³ Leeham Company, LLC Commercial Aviation Report, December 2005.

In another area, the expedited nature of the settlement agreement regarding the dual leasing of Hangar No. 673 and the lack of due diligence by SBIAA to verify the existence or extent of damages, or to independently obtain an opinion of value of collateral pledged for a \$550,000 loan, make the appropriateness of the settlement questionable. In addition, the settlement resulted in substantial cost to the taxpayer, which may be greater if SBD defaults on the loan and the market value of the aircraft used as collateral is not sufficient to repay the balance of the debt owed to SBIAA. The claim for damages arising from the aircraft hangar leasing dispute resulted in an expedited settlement with Spencer's companies, valued at approximately \$1.0 million.

Conclusions

San Bernardino International Airport Authority (SBIAA) has entered into multiple contracts with companies managed by a single individual, Scot Spencer. Mr. Spencer is a convicted felon who served time for bankruptcy fraud in a federal penitentiary and, in a separate matter stemming from businesses he managed at San Bernardino International Airport, was ordered by the United States Department of Transportation (DOT) to "permanently cease and desist from further marketing or other involvement in air transportation operations so that he is banned from the aviation industry." Mr. Spencer was ordered to pay civil penalties of \$1.0 million, which remain unpaid.

Mr. Spencer's history at SBIAA began in approximately 2003 as a manager of KCP Leasing & Services, LLC, which was leasing space for the storage of Boeing 727 aircraft. Over the years, his involvement with SBIAA has grown, until Norton Development Company, LLC and SBD Properties, LLC (SBD) – two other companies that he manages – were granted development contracts to construct a new Terminal and a Fixed Base Operator (FBO) facility at the airport. The initial combined cost estimate for these two projects was about \$43 million, but through January 2011, SBIAA had spent over \$125 million on the projects. Companies affiliated with Mr. Spencer received payments of \$7.4 million in developer fees, based on a percentage of total costs, and reimbursement of nearly all of their direct and indirect costs through that date.

As the development projects progressed, Mr. Spencer's companies were given responsibility for major aspects of airport operations. After approaching the Interim Executive Director with an informal proposal, Mr. Spencer was able to obtain agreement from a nationally recognized company to participate in FBO services at the airport. Mr. Spencer then gathered investors to open a franchise of that company, which he now manages, named *Million Air San Bernardino, LLC*. Subsequently, SBD was then awarded a 25-year lease to provide FBO services and run the airport fuel farm through *Million Air San Bernardino, LLC*.

SBIAA had also solicited proposals for a nationally recognized airport management company to operate the airport, but no responses were received. As an alternative, the Interim Executive Director negotiated a sole source contract with Mr. Spencer through San Bernardino Airport Management, LLC (SBAM), which Mr. Spencer formed for that purpose and now manages. Compensation for SBAM under a 25-year agreement with SBIAA guarantees payments of \$500,000 per year, reimbursement of most major operating costs, and the receipt of 50% of net operating income. SBIAA absorbs all financial risk.

The evolution of these sole source relationships between SBIAA and Mr. Spencer, and the growth in the involvement of the companies he manages, raises serious questions. Further, Mr. Spencer's activities at SBIAA are in direct violation of the DOT order, which states he should be "banned from the aviation industry."

Recommendations

Given Mr. Spencer's criminal history and Department of Transportation administrative law rulings against him, the SBIAA Board of Commissioners should:

- 5.1. Direct staff to review current contracts for construction services and Airport operations with the companies he manages, to identify modifications that may be necessary to protect the IVDA and SBIAA from potential future risk.

Costs and Benefits

There would be no cost to implement this recommendation.

SBIAA would limit exposure to the types of difficulties described throughout this report and would no longer be party to Mr. Spencer's apparent violation of the DOT order banning him from the aviation industry.

Attachment 3.1

Pictures of Un-Refurbished Jet Bridges

**Acquired for San Bernardino International Airport
by Norton Development Company, LLC from American Airlines**

Pursuant to SBIAA Resolution 2007-05

Pictures Taken March 2, 2011 at San Bernardino International Airport

Model: A2-58/85-125R Serial Number: OG-2166









Model: A2-58/85-125R **Serial Number:** OG-2167



Model: A2-58/85-125R **Serial Number:** OG-2165





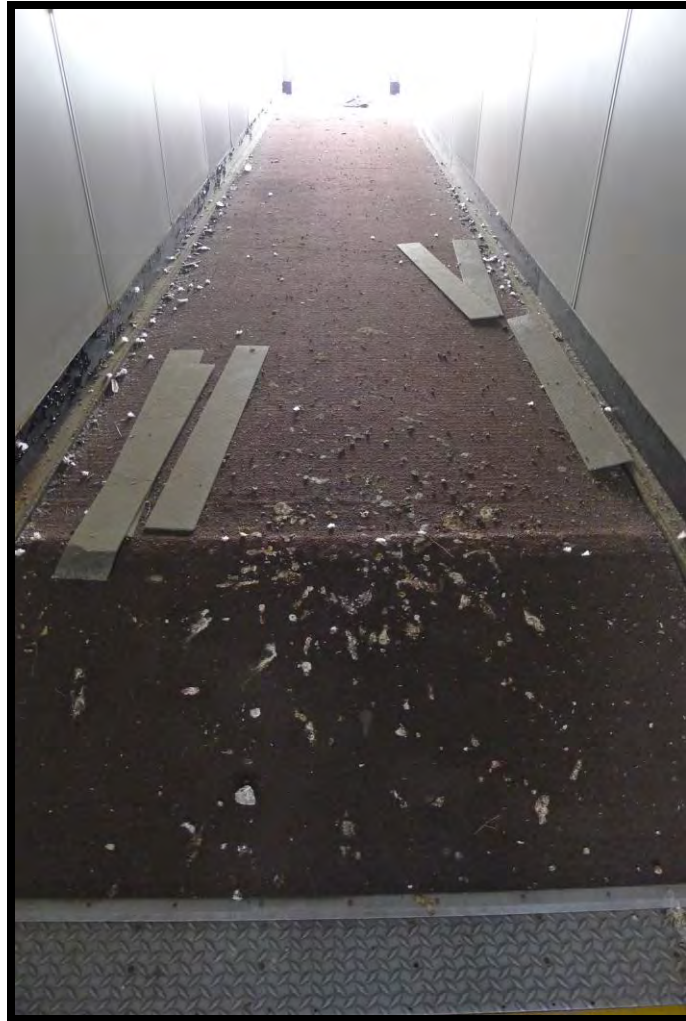
Note the type of aircraft serviced by this jet bridge: DC-10, MD-11, and B767.
All of these aircraft are wide body jet airliners, which are unlikely to service SBIA.
Further, DC-10 and MD-11 aircraft are rarely used by commercial airlines in the U.S.

Model: A2-58/85-125R Serial Number: OG-2285









Model: 21/29 Serial Number: OG-35456





AD HOC COMMITTEE – SECURITY

Melinda O'Connor, Chair

Bob Mitchell

Dawn Molumphy



AD HOC COMMITTEE SECURITY

Introduction

Grand Jury members from the Law and Justice committee toured the 911 call centers in Rialto and Victorville and found some security issues.

It was decided to form an Ad Hoc Committee to look into security and safety issues.

SECURITY ISSUES

BACKGROUND

This ad hoc was formed after a visit to the 911 call centers in Rialto and Victorville. The Ad Hoc Committee arrived at the Rialto center and entered the grounds through a malfunctioning gate then entered the building through an unlocked door.

The Ad Hoc Committee asked if the buildings would be able to hold up in a natural disaster and was told they would not. The Ad Hoc Committee asked about security measures such as alarms and cameras, and were told they had no cameras and the gate alarm had been disconnected years ago because of animals setting it off. If this facility was disabled, all communication with the Office of Emergency Services (OES), Cal Fire call center, and the Sheriffs 911 call center would cease. If the radio tower for the ham operator went down, the county's backup would be lost.

The committee interviewed management at each office in the facility. They were all in agreement that all the entities at this facility needed to be relocated to a permanent building. In an effort to see what other counties do to secure their emergency services members of the Ad Hoc Committee visited Riverside County's OES facility. They are in the process of building a new facility and moving. At this time, they also have problems with security. One of their issues was being in an old bomb shelter. The OES Director was able to share some of the things that will be included in the building to make it safe and secure. Some of these safeguards would be:

- Controlled Access
- Above Ground
- Single Story
- Shock Absorbers on the Building
- Perimeter Fencing
- Gated with Card Swiping Entrance
- Isolation of the Building

FINDINGS

Rialto

1. The magnetic lock on the gate was malfunctioning.
2. There were no cameras on site.
3. The fence did have an alarm but it was disconnected years ago because animals were setting it off.
4. The building would not withstand a natural disaster.

Victorville

5. The Victorville Center is attached to the courthouse.
6. There were no working cameras.
7. The door that is the employee's entrance at the 911 call center is close to the door used to release inmates. The employees have been accosted in the parking lot by these inmates asking for money or a ride.
8. The dispatch room is overcrowded and some of the work stations needed repair. Some keyboards were being propped up with pieces of wood and chairs were broken.

RECOMMENDATIONS

11-38 Move the Rialto facility to a permanent building. (Finding 4)

11-39 In Rialto, install cameras and repair the gates. (Findings 1, 2, 3)

- 11-39 In Victorville, install working cameras. (Finding 6)
- 11-41 In Victorville, provide every employee an escort to their vehicle. (Finding 7)
- 11-42 In Victorville, repair or replace broken workstations and chairs. (Finding 8)

<u>Responding Agency</u>	<u>Recommendations</u>	<u>Date Due</u>
Board of Supervisors	11-38 through 11-42	August 30, 2011



*A copy of this report, or more information on the San Bernardino County Grand Jury,
may be obtained by contacting:*

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San Bernardino Courthouse, Room 200
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San Bernardino, CA 92415-0243
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