MIAMIBEACH

BUDGET AND PERFORMANCE IMPROVEMENT
Internal Audit Division

INTERNAL AUDIT REPORT

TO: Jorge M. Gonzalez, City Manager
VIA: Kathie G. Brooks, Budget and Performance Improvement Director
FROM: James J. Sutter, Internal Auditor

DATE: January 29, 2010
AUDIT: Penrods Brothers Pier Park Restaurant Lease Agreement and Concession Agreement
PERIOD: April 1, 2006 to March 31, 2009

This audit report is the result of a regularly scheduled audit of the lease agreement between the City and Penrods Brothers Inc. (Penrods) concerning the operations of the Pier Park Restaurant and the related concession agreement for the adjacent City owned property known as Pier Park.

INTRODUCTION

On October 2, 1985, the Mayor and City Commission adopted Resolution No. 85-18223 and the related lease agreement authorized Penrods Brothers, Inc. for the development, construction, management and operation of a restaurant facility in Pier Park pursuant to Request For Proposal number 202-84/04 issued August 2, 1985. This lease agreement was for a period of twenty years expiring May 6, 2006 with two additional ten-year options periods. Along with this resolution, the Mayor and City Commission adopted Resolution No. 85-18222, approving a concession agreement with Penrods Brothers for the sale of food and beverages, rental of lounging and related equipment services within a portion of Pier Park, which expired on November 4, 2000. The City extended the concession agreement an additional year to allow for the issuance of a Request for Proposal (RFP) for the beachfront concessions. The RFP was issued February 21, 2001 and was subsequently awarded to Boucher Brothers Miami Beach LLC. The new concession agreement was approved by the Mayor and City Commission and became effective November 5, 2001 for a period of 5 years with an option to renewal for an additional five year term.. This concession agreement did not include the portion of Pier Park and the beaches seaward and immediately adjacent to the restaurant.

On February 25, 2004, the City entered into a separate concession agreement with Penrods by Resolution No. 2004-25506 for the portion of Pier Park immediately adjacent east of the restaurant since it was not included in the concession agreement awarded to the Boucher Brothers. This concession agreement commenced retroactively back on October 1, 2003 and the original term expiring on May 6, 2006 with an option to renew to run concurrent with the terms of the Pier Park Restaurant lease agreement. The City and Penrods Brothers agreed to revisit and negotiate the financial terms governing the restaurant lease agreement, in regards to percentage payments, and where a concession agreement would commence covering the rentals of lounging equipment and food and beverage sales in the portion of Pier Park seaward of the footprint of the Pier Park restaurant lease premise. Concurrently a third amendment to the Lease agreement was entered into on February 25, 2004 under resolution number 2004-25507.

Under the third amendment to the lease agreement, Penrods is to pay the City an annual Minimum Guarantee equal to a percentage of the Lessee's gross receipts commencing on October 1, 2003, and thereafter on May 7 of each year during the term of the lease agreement as well as any renewals. This annual Minimum Guarantee (equal to 5.5% per year of the Lessee's gross receipts) is to be paid as monthly percentage rent to the City by the fifteenth of the preceding month together with a statement of gross receipts for the preceding month. At the time of delivery to the City of the

Annual Statement of Gross Receipts, the Lessee shall pay any adjustment due the City. In addition, the City and Penrods have established a target revenue threshold of $12,818,026. Once the Lessee has met the target revenue, the monthly gross receipt percentage shall increase to 6.5% and every year after.

The lease agreement responsibilities is divided between two departments, the administration and enforcement of the lease agreement is handled by the Office of Asset Management, while the Finance Department is responsible for the processing and recording of the monthly rental payments.

The following chart list the rental payments received from Penrods in the last three years.

	FY 05/06 (Apr 06–Sept 06)	**FY 06/07**	**FY 07/08**	**FY 08/09** (Oct 08 –Mar. 09)	**Total**
Rental Payment	$364,540.86	$790,256.32	$731,075.92	$349,791.37	$2,235,664.47
Parking	1,487.25	2,798.50	2,426.87	1,143.92	7,856.54
Sales Tax*	25,431.22	55,304.23	51,163.42	24,437.20	156,336.07
Total Payments	$391,459.33	$848,359.05	$784,666.21	$375,372.49	$2,399,857.08

* The State sales tax figure represents the total amount of sales tax remitted by the City to the State based on Penrods rental payments. The City's financial system separates Penrods applicable sales tax payments into two general ledger accounts (one for the Parking Operations Fund and one for the General Trust Fund).

OVERALL OPINION

Penrods operates with sufficient controls in place to ensure essential accuracy of sales reported, and internal controls were found to be sufficient and the documentation maintained was well organized and complete. In addition, sales taxes were properly remitted, transactions were properly recorded in the City's financial system, insurance requirements were complied with and property taxes were timely paid by the lessee. The following findings highlight the areas that need improvement:

- Penrods did not increase their lease payment in the fourth year of the contract after meeting the contracted target revenue threshold amount. However, this was subsequently discovered by the Office of Asset Management and Penrods remitted payment for the amount due.

- Penrods did not remit eight of the monthly gross receipts by the due date of the fifteenth day of the following month. Neither Finance nor Asset Management subsequently invoiced Penrods for any interest on these late payments.

- Penrods annual statements of the gross receipts certified by an independent Certified Public Accountant were not received timely.

PURPOSE

The purpose of this audit was to determine whether the lessee paid the correct rent based upon their supporting records, was otherwise in compliance with the lease agreement; and whether the City received and correctly recorded all revenues and sales taxes and effectively monitored the lease agreement.

SCOPE

1. Confirm by examination of the concessionaire's records that all remitted revenues for the concession areas to include the rental equipment and lounging, the food and beverage services were correctly calculated and remitted in accordance with the signed agreement.

2. Confirm that all monthly percentage rents paid to the City were received timely during the audit period. The City's monthly minimum guarantee is due by the fifteenth of the month for the proceeding month.

3. Confirm that the Finance Department receives the sales and use tax from the concessionaire and remits it to the State.

4. Confirm that all transactions were properly recorded in the City's financial system.

5. Confirm that the annual statements of the gross receipts certified by an independent Certified Public Accountant were timely submitted and the amounts reported therein agreed with corresponding amounts previously report to the City.

6. Confirm that all insurance requirements of the lease agreement were complied with.

7. Confirm that all property taxes were timely paid to Miami Dade County.

FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Finding: *Monitoring for Contract Provision of Targeted Revenue Thresholds*
   Gross receipts recorded on the lessee's books and records were adequately supported by documentation and in agreement with the amounts reported to the City. However, Penrods did not increase their lease payment in the fourth year of the contract after meeting the contracted target revenue threshold amount.

   Paragraph 4.2.1 of the concession agreement specifies that the monthly 5.5% of the minimum guarantee amount should be increased to 6.5%, once the cumulative target revenue of $12,818,026 has been reached. Paragraph 4.2.2 of the concession agreement states once the target revenue threshold has been reached, the Concessionaire shall pay the City in a lump sum, the difference between the 5.5% and 6.5% for the contract year the target was met.

   The target revenue threshold was met during the fourth contract year May 7, 2006 thru May 6, 2007; upon subsequent discovery by the Asset Management Department, the City notified the Lessee in August 2008 of the amount due representing $393,490.32 in lease payments, with an accumulation of interest of $105,941.86, totaling to $499,432.18.

   On February 27, 2009, the City agreed to having Penrods pay $393,490.33, representing the amount for past due minimum guarantee payments before April 23 2009. Furthermore in this settlement, it was agreed that the past due interest of $105,941.86, would be reduced to an amount of 80% or $84,753.39 allowing for monthly installments of $7,062.79 to be made over a twelve (12) month period starting on May 1, 2009. To date, the Lessee has timely paid the $393,490.33 and two Interest payments.

Recommendation
Going forward, the Office of Asset Management should establish a tickler system enabling them to monitor for compliance for any revenue requirements within their agreements. The City's Eden's Contract Management software can be utilized to better track compliance to terms of the agreement.

Management Response:
Asset Management will work with Finance to monitor the timely submission of any revenue requirements. Additionally, Asset Management is in the process of developing and implementing a tracking system to monitor contract requirements.

2. Finding: *Interest for Late Payments*
In accordance with the agreement, the Lessee must submit each monthly gross receipts payment by the fifteenth of the following month. During the audit period there were a total of eight late payments by an average of four days based on review of the City's stamped received date.

In accordance with Section 4.4 entitled "Interest for Late Payment" any payment not received by the due date is subject to interest at a rate of (12%) per annum, from the due date of payment until such time the payment is received. The calculation of interest not billed for late payments during our audit period amounted to $690.77; this amount was based upon calculating interest charges from the fifteenth of the month. An additional sixteen payments are also considered to be late, however since the Finance department did not stamp the date received, the City is not able to invoice for late payment.

Recommendation(s):
The Office of Asset Management should prepare a City bill for $690.77 for the interest due for the above late payments. In addition, the Office of Asset Management should remind the Lessee that all checks should be sent directly to the City's Finance Department. Furthermore, the Office of Assets Management should coordinate with the Finance Department to be notified on the receipts of payments so that payments can be monitored for timely acceptance. Interest due on any late payments should be billed by the Office of Assets Management.

Management Response:
The Office of Asset Management will notify and invoice Tenant's/Concessionaire's for late payments. The Office of Asset Management will work with the Finance Department to reinstitute the previous process of receiving monthly reports from the Revenue Manager indicating all payments received by the Finance Department. Since said payments (and corresponding financial reports) are sent directly by the payee, as required by contract, to the Revenue Manager, this report to be generated by the Finance Department will assist the Office of Asset Management in identify those entities that are not paying in a timely manner, and notify same accordingly.

3. Finding: *Submittal of Annual Statement of Gross Receipts*
There is conflicting terminology in both the lease and concession agreements as to when the Annual Statement of Gross Receipts are due and for what period the financial statements should represent.

Section 15 of Penrods' original lease agreement dated November 7, 1985 states "*within sixty (60) days after each fiscal year, Lessee shall deliver to the City a written annual statement of the gross receipts for such fiscal year. Said statement shall be certified as true, accurate and complete by Lessee, by and through a duly authorized independent Certified Public Accountant (CPA).*" There is no definition as to what period the fiscal year covers. On the other hand, the third amendment to the lease agreement, dated February 25, 2004, under section 13.3 refers to section 15 of the original lease agreement as to when the Annual Statement is due. However, under section 13.3.2 of the same amendment to the lease, the Lessee may have to pay an additional lump sum if it does not meet the minimum guarantee payment "*at the time of delivery to the City of the Annual Statement of Gross Receipts no later than June 30, of each Lease year during the term, including renewal terms, of this lease.*"

In addition, the corresponding concession agreement dated February 25, 2004, under section 6 paragraph 3 states "*that within 60 days after each contract year, the Concessionaire shall submit to the City a written Annual Statement of Gross Receipts for such contract year.*"

The Annual Statements of Gross Receipts submitted by the Lessee represented their fiscal years ending December 31st. The statements for 2006, 2007 and 2008 were received an average of 55 days past the due date of 60 days. There was no correspondence between the City and Penrods requesting these late statements. We compared the revenues reported on these statements to the amounts reported to the City and found no exceptions.

With both the lease and concession agreements now requiring a settlement of actual rent paid verse the minimum guarantee after each contract year based upon the receipt of annual statements, we feel that the period of the Annual Statement of Gross Receipts should be the contract year (May 7th to May 6th). This will allow a better comparison of the amounts reported during the contract year for both the lease and concession agreements.

Recommendation(s):
The City should request that going forward the period reported under the Annual Statement of Gross receipts should be the contact year ending May 6th. The Office of Asset Management should ensure that the CPA statements are received in a timely manner. Meanwhile, the Finance Department should compare the certified figures with the reported amounts for agreement. If there is a discrepancy between what was submitted and what was reported by the CPA, inquiries should be made to see if the City is owed additional money.

Management Response:
Asset Management will work with Finance to monitor the timely submission of any required statements. Pending Tenant/Concessionaire's review and submission of comments, a Letter of Understanding could be executed between the parties to the Agreements that will clarify and set forth all future reporting due dates.

EXIT CONFERENCE

An exit meeting was held October 2, 2009 to discuss the audit report and to solicit management responses noted above. Participants included Anna Parekh, Director, Office of Real Estate, Housing & Community Development, Robert Reboso, Redevelopment Specialist - Asset

Management, James Sutter, Internal Auditor and Laura Franco-Rubines, Assistant Internal Auditor. Management responses were received thereafter and incorporated in the report. The Tenant/Concessionaire was provided a copy of the preliminary report. All were in agreement with the contents of this report.

JS:LR:lr
(Audit performed by Laura Franco-Rubines, Assistant Internal Auditor)

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cc: Hilda Fernandez, Assistant City Manager
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Robert Reboso, Redevelopment Specialist - Asset Management
Jack Penrod, President, Penrods Brothers, Inc.
Patricia Walker, Chief Financial Officer