

City of Miami

THEODORE P. GUBA, CPA, CIA, CFE
INDEPENDENT AUDITOR GENERAL



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September 21, 2015

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

Re: Audit of Biscayne Bay Restaurant Corporation d/b/a Rusty Pelican Restaurant (BBRC), for the period July 1, 2011 through June 30, 2013
Audit No. 15-003

Executive Summary

We have completed an audit of records and selected financial transactions of Biscayne Bay Restaurant Corporation d/b/a Rusty Pelican Restaurant (BBRC), primarily for the period July 1, 2011 through June 30, 2013. The audit was performed to determine whether BBRC complied with the applicable sections of its Lease Agreement (Lease) with the City of Miami (City). During the lease years of 2012 and 2013, BBRC made base rent payments totaling \$360,000 per year, in addition to percentage rent payments totaling \$498,644 and \$578,453, respectively. Percentage rent payments for 2012 and 2013 were based on reported total gross revenues of \$7.5 million and \$11.4 million, respectively.

It should be noted that BBRC was unable to provide us with applicable bank deposit transactions covering the audit period since deposits were comingled with those from its other restaurant operations. As a result of this impairment to the performance of audit procedures, we performed alternative procedures using point of sale reports generated by BBRC to perform a reconciliation of reported sales to the City, which is the basis for computing rental payments. We also plan to audit the period from July 1, 2013 through June 30, 2015 since we were informed that complete bank deposit transactions are available for this period as well as point of sale reports. We will then re-evaluate the effectiveness of the alternative procedures performed during this audit and make retroactive adjustments, if appropriate. (See Finding 1, page 3)

Overall, we concluded that except for certain controls over gross revenue reporting and insurance coverage that required strengthening, procedures and compliance with the Lease were generally adequate and being adhered to. Improvement is needed to ensure that BBRC's gross revenue, which is the basis for the percentage rent they are obligated to pay, is adequately supported with timely submitted, sufficient and appropriate documentation. This should include complete and accurate bank deposit transactions that are dedicated to the operations of this restaurant, rather than being comingled with deposit information from other restaurants. Also, BBRC should possess insurance coverage based on the appraised replacement cost of the property.

We wish to express our appreciation for the cooperation and courtesies extended to us by the BBRC management and accounting staff as well as the City's Department of Real Estate and Asset Management while conducting the audit.

Sincerely,



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

cc: The Honorable Mayor Tomas Regalado
Daniel Alfonso, City Manager
Victoria Mendez, City Attorney, City Attorney's Office
Alberto N. Parjus, Assistant City Manager
Nzeribe Ihekweba, Assistant City Manager/Chief of Operations
Fernando Casamayor, Assistant City Manager/Chief Financial Officer
Mark Burns, Lease Manager, DREAM (Department of Real Estate and Asset Management)
Daniel Rotenberg, Director, DREAM (Department of Real Estate and Asset Management)
Jose Fernandez, Director, Finance Department
Ann-Marie Sharpe, Director, Risk Management Department
Miguel Augustin, Controller, Finance Department
Frank Gomez, Property & Casualty Manager, Risk Management Department
Demetrio Constantiny, Accounts Receivable Supervisor, Finance Department
Ryan Smith, Managing Director, Specialty Restaurants Corporation
Charles Ochoa, CFO, Specialty Restaurants Corporation
Members of the Audit Advisory Committee
Audit Documentation File

Audit conducted by: Mala Khilnani, CPA, CISA, Senior Auditor
Paulino Garcia, Staff Auditor

Audit reviewed by: Lewis Blake, CPA, CIA, Audit Manager

**AUDIT OF BISCAYNE BAY RESTAURANT CORPORATION
JULY 1, 2011 THROUGH JUNE 30, 2013
AUDIT NO. 15-003**

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SCOPE, OBJECTIVES AND METHODOLOGY

The scope of the audit was to determine Biscayne Bay Restaurant Corporation's (BBRC) compliance with the rental payment and insurance provisions of its Lease Agreement (Lease) with the City of Miami (City). The audit primarily covered the period July 1, 2011 through June 30, 2013 and focused on the following objectives:

- To determine whether BBRC complied with the terms of the Lease to the extent that their rental payments to the City were consistent with: gross revenues periodically reported to the City; sales and use tax returns reported to the State of Florida; and, point of sale (POS) sales reports.
- To determine whether BBRC rental payments were accurate and remitted in a timely manner.
- To determine whether insurance policies were adequate and in compliance with Lease terms.
- To determine whether adequate internal controls were maintained.
- Other audit procedures as deemed necessary.

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

- Interviews and inquiries of appropriate personnel.
- Reviews of written policies and procedures in order to gain an understanding of the internal controls.
- Observations of current practices and processing techniques.
- Tests of applicable transactions and records.
- Other audit procedures as deemed necessary.

BACKGROUND

The City of Miami (City) owns a twenty-one (21) acre waterfront site on Rickenbacker Causeway, which is part of the City's Miami Marine Stadium complex. Subsequent to issuing a request for proposal (RFP) to develop and operate a high class restaurant at the Marine Stadium complex, the City executed a Lease Agreement (Lease), dated February 13, 1970, with Biscayne Bay Restaurant Corporation (BBRC), (a Florida Corporation and a wholly owned subsidiary of Specialty Restaurants Corporation [SRC], a California corporation) d/b/a Rusty Pelican.

In accordance with the terms of the Lease, BBRC constructed a pedestrian walkway (the "Baywalk") and an outdoor deck (the "Vista Point") in consideration for the extension of the term of the lease to October 1, 2027.

BBRC is required to pay the City stipulated base rent payments of \$360,000 per year or \$30,000 per month. Based on revenues generated from the restaurant (Rusty Pelican) BBRC is required to pay "Percentage Rent" as outlined in the Lease. For the lease years ended June 2012 and June 2013, "Total Gross Revenues" were \$7.5 million and \$11.4 million, respectively, and BBRC paid the City \$670,779 and \$859,570 in base and percentage rent, respectively.

AUDIT FINDINGS AND RECOMMENDATIONS

CONCLUSION: It should be noted that BBRC was unable to provide us with applicable bank deposit transactions covering the audit period since deposits were comingled with those from its other restaurant operations. As a result of this impairment to the performance of audit procedures, we performed alternative procedures using point of sale reports generated by BBRC to perform a reconciliation of reported sales to the City, which is the basis for computing rental payments. We also plan to audit the period from July 1, 2013 through June 30, 2015 since we were informed that complete bank deposit transactions are available for this period as well of point of sale reports. We will then re-evaluate the effectiveness of the alternative procedures performed during this audit and make retroactive adjustments, if appropriate. (See Finding 1, page 3)

Overall, we concluded that except for certain controls over gross revenue reporting and insurance coverage that required strengthening, procedures and compliance with the Lease were generally adequate and being adhered to. Improvement is needed to ensure that BBRC's gross revenue, which is the basis for the percentage rent they are obligated to pay, is adequately supported with timely submitted, sufficient and appropriate documentation. This should include complete and accurate bank deposit transactions that are dedicated to the operations of this restaurant, rather than being comingled with deposit information from other restaurants. Also, BBRC should possess insurance coverage based on the appraised replacement cost of the property.

Details of our findings and recommendations follow:

FINDING 1: IMPAIRMENT TO THE PERFORMANCE OF AUDIT PROCEDURES

Impairment/Scope Limitation Defined

Generally Accepted Government Auditing Standards (GAGAS) Chapter 8.11 state that "Auditors should also report significant constraints imposed on the audit approach by information limitations or scope impairments, including denials of access to certain records or individuals." In addition, according to the Institute of Internal Auditors (IIA) International Standards Practice Advisory No. 1130-1, a scope limitation is a restriction placed upon the internal auditing department that precludes the department from accomplishing its objectives and plans. Among other things, a scope limitation may restrict the:

- Scope defined in the charter
- Department's access to records, personnel, and physical properties relevant to the performance of audits
- Approved audit work schedule
- Performance of necessary auditing procedures
- Approved staffing plan and financial budget

The Impairment Described

BBRC is required to accurately report its gross receipts to the City and provide requested documents (to support whatever is reported) in a timely manner in accordance with its lease agreement with the City. As such, beginning in May 2014, the City's Office of the Independent Auditor General (OIAG) requested bank deposit transactions covering our scope period from BBRC. The bank deposit transactions were required for the performance of audit procedures that provide reasonable assurance of the accuracy of gross receipts generated at the Rusty Pelican Restaurant (RP). Specifically, the deposit transactions were needed in order to perform a cash-

to-accrual reconciliation for each year under audit. Several requests were sent to BBRC in order to identify the RP deposit transactions in the bank statements since BBRC uses one bank account to deposit cash and credit card sales generated by its 19 restaurants. However, complete deposit transactions were never provided by BBRC due to various staffing issues.

Since we did not receive all of the deposit transactions, during June 2015, we employed alternative auditing procedures by using RP's Point of Sale (POS) monthly reports in lieu of the bank deposits to reconcile sales reported to the City. However, there may be certain transactions that are recorded by the bank that are not reflected in the POS system.

It should be noted that we plan to audit the period from July 1, 2013 through June 30, 2015 by performing a reconciliation of reported sales using both the bank deposit transactions and POS reports, since BBRC has indicated that this information is available for that period. We will re-evaluate the effectiveness of the alternative procedures performed during this audit, and make adjustments, if appropriate. Upon audit inquiry, BBRC stated that they have requested that a separate bank account be created specifically for Rusty Pelican operations.

RECOMMENDATION 1.1: (DEPARTMENT OF REAL ESTATE AND ASSET MANAGEMENT)

We recommend that the Department of Real Estate and Asset Management (DREAM) amend provisions of the Lease and require BBRC to establish a separate bank account and statements for RP operations.

- **DREAM Response:**

We will reach out to the Lessee and see if they are willing to amend this portion of the agreement.

- **Implementation Date:** 9/18/15

FINDING 2: INSURANCE COVERAGE WAS NOT IN COMPLIANCE WITH LEASE TERMS

In accordance with Paragraph 21 (vii) of the Lease Agreement (Lease) between the City of Miami (City) and BBRC:

“...commencing on September 1, 2013 and every four years thereafter, the replacement cost of the Insured Property shall be adjusted pursuant to an appraisal conducted by an insurance appraiser, selected and paid for by the Lessee, provided that the Lessee shall obtain Lessor’s approval (which approval shall not be unreasonably withheld, conditioned or delayed) of the appraiser before the commencement of the appraisal. The appraiser selected by the Lessee shall submit a written report of the appraised replacement cost to the Lessor and Lessee by July 15th in the year of the adjustment.”

Based on our review of the Lease and supporting documentation, we noted that BBRC did not obtain an appraisal commencing on September 1, 2013, or shortly thereafter, in order to determine the current replacement cost of the property. Not obtaining such an appraisal and ascertaining the property’s current replacement cost could cause the property to be underinsured

and increase the City's risk of sustaining a material financial loss in the event of a major catastrophe.

RECOMMENDATION 2.1: (BISCAYNE BAY RESTAURANT CORPORATION)

We recommend that BBRC obtain the necessary appraisal as required in the Lease in order to adjust the replacement cost and insurance coverage of the City's property.

- **BBRC Response:**

We will work with the City's Real Estate Asset Management Department to ensure a proper appraisal is performed and follow up with our insurance broker should an adjustment be warranted.

- **Implementation Date:** 10/15/15

RECOMMENDATION 2.2: (REAL ESTATE AND ASSET MANAGEMENT DEPARTMENT)

We recommend that the Department of Real Estate and Asset Management (DREAM) periodically monitor insurance provisions of City lease agreements in order to ensure lessee adherence to all insurance requirements.

- **DREAM Response:**

We will work with Risk Management to ensure that all insurance provisions are complied with.

- **Implementation Date:** 10/15/15