

City of Miami

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INDEPENDENT AUDITOR GENERAL



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March 29, 2017

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

Re: Audit of the Jungle Island Facility Lease and Development Agreement
Report No. 17-03

Executive Summary

We have completed an audit of records and selected financial transactions of the Jungle Island (JI) facility, primarily for the period January 1, 2012 through December 31, 2016. The audit was performed because Parrot Jungle and Gardens of Watson Island, Inc. (PJG); the entity that leases and operates JI; entered into an agreement to transfer its rights under its Lease and Development Agreement (Lease) with the City of Miami (City) to another party. Therefore, City management engaged the Office of the Independent Auditor General (OIAG) to 1) provide reasonable assurance that there were no additional rental payments due to the City during the period January 1, 2012 through December 31, 2016; and 2) calculate the transfer fee as stipulated in the lease that is due to the City as a result of the anticipated transfer of leasehold interests. It should be noted that the OIAG will subsequently perform additional procedures to provide reasonable assurance that there are no other rental payments due to the City through the 2017 transfer closing date, which has yet to be determined.

In accordance with provisions of the Lease, PJG's monthly rental payments due to the City are based on the greater of monthly minimum rent (\$41,847) and monthly percentage rent, which is 5% of PJG's gross revenues for the month commencing 60 days prior to when the rent is due. Therefore, our audit procedures included an examination of PJG's reported 2012 through 2016 gross revenues and paid rents which were as follows:

Year	Gross Revenue (millions)	Rent Paid
2012	\$14.7	Deferred
2013	\$15.2	\$750,044
2014	\$14.5	\$773,840
2015	\$15.9	\$854,582
2016	\$13.1	\$702,834
Total	\$73.4	\$3,081,300

When we compared the 2012, 2013 and 2014 gross revenues PJG reports to the City with gross revenues indicated in PJG's Florida Sales and Use (SU) tax returns, we noted short-falls of revenues

reported to the City of \$49,684 (.34%), \$7,438 (.05%), and \$125,119 (.87%), respectively. In addition, when we compared the 2015 and 2016 revenues with appropriately adjusted bank statement deposits, we noted short-falls of \$750,375 (5%) and \$369,561 (3%), respectively. The shortfalls total \$1,302,177 (2%), and additional rent of **\$65,209** is currently owed to the City after adjustments. In addition, for 2012, JI owes the City **\$2,658** in additional deferred rent which is payable on December 31, 2020.

Lastly, since PJG is opting to transfer its leasehold interests, the Lease stipulates that it must pay the City a transfer fee of 3% of the net proceeds from the sale. Therefore, based on our calculations, PJG also owes the City a transfer fee of **\$469,062**, which will be recalculated and billed as of the closing date of the transaction. As a result, PJG owes the City a total of **\$534,271** plus \$2,658 in deferred rent. (See Schedule 1, below).

SCHEDULE 1

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>Totals</u>
Reconciled Gross Rev.	\$14,752,209	\$15,241,428	\$14,589,422	\$16,690,240	\$13,506,652	\$74,779,951
Gross Rev Reported To City	\$14,702,525	\$15,233,990	\$14,464,303	\$15,939,865	\$13,137,091	\$73,477,774
Reporting Shortage	\$49,684	\$7,438	\$125,119	\$750,375	\$369,561	\$1,302,177
Percentage Rent – (5%)	\$2,484	\$372	\$6,256	\$37,519	\$18,478	\$65,109
Sales Tax – (7%)	\$174	\$26	\$438	\$2,626	\$1,293	\$4,558
Subtotal of Additional Rent	\$2,658	\$398	\$6,694	\$40,145	\$19,771	\$69,666
Less: 2012 Deferred Rent						(\$2,658)
<i>(this amount is in addition to rent already deferred and payable in 2020)</i>						
Less: 2015 Overpayment						(\$1,799)
Total Additional Rent Currently Owed the City						\$65,209
Plus: Transfer Fee - (see Finding 2, page 6)						\$469,062
Total Additional Rent and Transfer Fees owed the City						\$534,271
Plus: Deferred Rent						\$2,658
GRAND TOTAL						\$536,929

We wish to express our appreciation for the cooperation and courtesies extended to us by all personnel 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
Fernando Casamayor, Assistant City Manager/Chief Financial Officer
Alberto Parjus, Deputy City Manager/Chief of Infrastructure
Nzeribe Ihekweba, Assistant City Manager/Chief of Operations
Victoria Mendez, City Attorney, City Attorney's Office
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**AUDIT OF JUNGLE ISLAND
FACILITY LEASE AND DEVELOPMENT AGREEMENT
JANUARY 1, 2012 THROUGH DECEMBER 31, 2016
REPORT NO. 17-03**

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SCOPE, OBJECTIVES AND METHODOLOGY

The scope of the audit was to determine Parrot Jungle and Gardens of Watson Island, Inc. (PJG) compliance with the rental payment provisions of its Lease with the City and to calculate the transfer fee as stipulated in the lease that is due to the City as a result of the anticipated transfer of leasehold interests. The audit primarily covered the period January 1, 2012 through December 31, 2016 and focused on the following objectives:

- To determine whether PJG reported the accurate amount of Gross Revenue for the period January 1, 2012 through December 31, 2016, which were the basis of percentage rental payments made to the City through December 31, 2016.
- To determine whether PJG rental payments were accurate and in compliance with the Lease terms.
- To calculate the transfer fee due to the City as stipulated in the lease.
- 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

On September 2, 1997, the City leased an 18.6 acre parcel of land on Watson Island to Parrot Jungle and Gardens of Watson Island, Inc. (PJG) for the development and operation of the Jungle Island (JI) facility. However during 2016, PJG entered into an agreement to transfer its rights under its Lease. Accordingly, the objective of this audit is to; 1) provide reasonable assurance that there are no additional rental payments due to the City during the period January 1, 2012 through December 31, 2016; and 2) calculate the transfer fee as stipulated in the lease that is due to the City as a result of the anticipated transfer of leasehold interests. However, additional procedures must be performed in order to provide reasonable assurance that there are no other rental payments due to the City through the 2017 transfer closing date which has yet to be determined. Lastly, it should also be noted that a prior audit of PJG financial transactions for the period January 1, 2007 through December 31, 2011 was performed in 2012 (Audit No. 13-007), with no exceptions noted regarding rental payments and reported gross revenue. However, rent for the period April 2009 through March 2013 was deferred and payable in 2020 as a result of an amendment to the agreement.

AUDIT FINDINGS AND RECOMMENDATIONS

CONCLUSION: Overall, we have concluded that when we compared the 2012, 2013 and 2014 gross revenues PJG reports to the City with gross revenues indicated in PJG’s Florida Sales and Use (SU) tax returns, we noted short-falls of revenues reported to the City of \$49,684 (.34%), \$7,438 (.05%), and \$125,119 (.87%), respectively. In addition, when we compared the 2015 and 2016 revenues with appropriately adjusted bank statement deposits, we noted short-falls of \$750,375 (5%) and \$369,561 (3%) respectively. The short-falls total \$1,302,177 (2%), and additional rent of **\$65,209** is currently owed to the City after adjustments. In addition, for 2012 JI owes the City **\$2,658** in additional deferred rent which is payable on December 31, 2020.

Lastly, since PJG is opting to transfer its leasehold interests, the Lease stipulates that it must pay the City a transfer fee of 3% of the net proceeds from the sale. Therefore, based on our calculations, PJG also owes the City a transfer fee of **\$469,062**, which will be recalculated and billed as of the closing date of the transaction. As a result, PJG owes the City a total of **\$534,271** plus \$2,658 in deferred rent. (See Schedule 1, in Executive Summary).

Details of our findings and recommendations follow:

FINDING 1: DIFFERENCES IN CALCULATIONS OF GROSS REVENUE RESULTED IN UNDERPAYMENTS OF RENT TOTALING \$65,209

Overview

Pursuant to Lease provisions, PJG’s monthly rental payments due to the City are based on the greater of monthly minimum rent (\$41,847) and monthly percentage rent, which is 5% of JI’s gross revenues for the month commencing 60 days prior to when the rent is due. Therefore, our audit procedures included an examination of JI’s reported 2012 through 2016 gross revenues and paid rents which were as follows:

Year	Gross Revenue (millions)	Rent Paid
2012	\$14.7	Deferred
2013	\$15.2	\$750,044
2014	\$14.5	\$773,840
2015	\$15.9	\$854,582
2016	\$13.1	\$702,834
Total	\$73.4	\$3,081,300

Testing Methodology

In order to determine whether PJG paid the correct amount of percentage rent during 2012 through 2014, we performed a reconciliation of gross revenue reported to the City to revenue reported to the State of Florida Department of Revenue (DOR) via PJG SU tax returns (adjusted for gratuities and other non-revenue items). It should be noted that we judgmentally decided to use this testing methodology due to high turn-over of PJG accounting staff during this period and the resulting inadequacy of accounting information.

However, for 2015 through 2016, in order to determine whether PJG paid the correct amount of percentage rent, we performed reconciliations of gross revenue reported to the City to all cash

deposited by PJG into bank accounts. Accordingly, we obtained all bank deposits and adjusted for timing differences with respect to accounts receivable and advance deposits. In addition, we made adjustments for various items that should be excluded from gross revenue including sales and use taxes collected, service charges (gratuities/tips), and other non-revenue items such as partner/sub-lessee commissions and rent.

Results

As indicated in the Schedule 2 below, when we compared the 2012, 2013 and 2014 gross revenues PJG reports to the City with gross revenues indicated in PJG's SU returns, we discovered reporting shortages of \$49,684 (.34%), \$7,438 (.05%), and \$125,119 (.87%), respectively. However, we noted that the \$2,658 JI owes the City in additional rent is deferred in accordance with an amendment to the lease and is payable on December 31, 2020. Accordingly, for 2013 and 2014, JI currently owes the City additional rent of \$398 and \$6,694 respectively for a total of \$7,092.

SCHEDULE 2 - RECONCILIATION OF REVENUES - JUNGLE ISLAND (JI)

	Year Ended 12/31/2012	Year Ended 12/31/2013	Year Ended 12/31/2014
Revenue Per Sales and Use Tax Return (SU)			
Parrot Jungle and Gardens, Inc.	\$6,757,218	\$7,666,959	\$7,585,385
PJG Watson, LLC.	\$8,668,292	\$6,207,083	\$516,979
Plus: Partners/Sub lessee's Gross Revenues			
Ovations Food Services LP		\$1,714,895	\$5,627,230
Wildlife Trading Company		\$77,070	\$705,629
Plus: Sharpshooters/Spectrum Rev.			\$678,921
Less: Gratuities paid to employees (A)	(\$673,301)	(\$424,578)	(\$332,385)
Less: JI Sales included in Ovations (B)			(\$192,337)
Reconciled Gross Revenue	\$14,752,209	\$15,241,428	\$14,589,422
Gross Revenue Reported to the City	\$14,702,525	\$15,233,990	\$14,464,303
Reporting Shortage	(\$49,684)	(\$7,439)	(\$125,119)
Percentage Rent - 5% of Gross Revenue	\$2,484	\$372	\$6,256
Sales Tax	\$174	\$26	\$438
(C) Amounts owed to City	\$2,658	\$398	\$6,694
TOTAL CURRENTLY DUE		\$7,092	
(A) =	Gratuities paid to employees are excluded from Gross Revenue as per the lease.		
(B) =	JI sales that were also included in previous reported Ovations sales were adjusted.		
(C) =	The \$2,658 amount due (in 12/31/2020) for 2012 is deferred rent; the remaining amounts (\$398 and \$6,694) are currently due.		

In addition, when we compared reported 2015 and 2016 revenues with our reconciliations of cash deposits, we discovered short-falls of \$750,375 (5%) and \$369,561 (3%) respectively. (See Schedule 3, below). Accordingly, for 2015 and 2016, JI owes the City additional rent of \$40,145 and \$19,771, respectively, for a total of \$58,117, adjusted for an overpayment of \$1,799.

SCHEDULE 3 - RECONCILIATION OF GROSS REVENUES - JUNGLE ISLAND (JI)

	Year Ended (D) 12/31/2015	Period Ended (D) 10/31/2016
Bank Deposits	\$14,617,496	\$10,452,222
Plus: Accounts Receivable Increase	\$82,164	
Less: Accounts Receivable Decrease		(\$195,205)
Plus: Partners/Sub lessee's Gross Revenues		
Ovations Food Services, LP	\$6,275,056	\$4,605,304
Wildlife Trading Company	\$803,831	\$658,486
Sharpshooters/Spectrum Venture, LLC	\$1,012,086	\$857,808
Paradise Parking	\$139,535	\$619,311
Less: Sales & Use Tax collected (C)	(\$581,688)	(\$452,719)
Less: Gratuities paid to employees (A)	(\$364,348)	(\$262,489)
Less: JI Sales included in Ovations (B)	(\$331,732)	(\$164,864)
Less: Non-Revenue Deposits		
Partner Commissions/Rent	(\$2,033,495)	(\$2,045,112)
Capital Contributions/Loans	(\$2,704,284)	(\$129,900)
Advance Deposits	(\$34,151)	(\$121,538)
Change Order Deposits	(\$135,332)	(\$122,265)
Miscellaneous Deposits/Refunds	(\$54,898)	(\$192,386)
Reconciled Gross Revenue	\$16,690,240	\$13,506,652
Gross Revenue Reported to the City	(\$15,939,865)	(\$13,137,091)
Reporting Shortage	\$750,375	\$369,561
Percentage Rent - 5% of Gross Revenue	\$37,519	\$18,478
Sales Tax	\$2,626	\$1,293
Amounts owed to City	\$40,145	\$19,771
Less: Overpayment	(\$1,799)	
TOTAL DUE	\$58,117	
(A) =	According to the lease, Gratuities paid to employees are excluded from Gross Revenue GR.	
(B) =	JI sales that were also included in Ovations sales.	
(C) =	According to the lease, SU taxes collected are excluded from GR.	
(D) =	Monthly rental payments are based on gross revenues for the month commencing 60 days prior to when the rent is due.	

When the additional rent of \$7,092 that JI currently owes for 2012 through 2014 is added to \$58,117 it owes for 2015 and 2016, JI owes a total of \$65,209 in additional rent to the City. It should be noted that we will perform additional procedures to ensure rental payments due to the City are reasonable through the closing date of the transaction.

RECOMMENDATION 1: (DREAM)

We recommend that DREAM take steps to immediately bill PJG \$65,209 that is due to the City.

- **DREAM Response:**

We will take steps to collect the \$65,209 currently due to the City.

FINDING 2: TRANSFER FEE DUE TO THE CITY TOTALING \$469,062

Overview

Since PJG is opting to transfer its leasehold interests, the Lease stipulates that:

*“upon receipt by Lessee of the proceeds related to such transfer or sale, Lessee shall pay Lessor an amount equal to three (3%) percent of the total purchase price less the amount of outstanding debt secured by leasehold mortgages and less the return of Lessee’s unamortized equity invested by the owner of the interest being transferred. For purposes of this Lease, the **unamortized equity** shall be defined as the equity Invested by the owner of the interest being transferred amortized on a straight-line basis over a 20 year period from the calendar year in which it was invested, with said unamortized equity investment accruing an annual rate of return of 5%.”*

Results

When we added the \$12.1 million unamortized equity balance to the \$32.3 balance of the leasehold mortgages and subtracted the \$44.4 million total from the \$60 million sales amount, we calculated net proceeds of \$15.6 million. Therefore, based on the 3% transfer fee stipulated in the Lease, the transfer fee due to the City is **\$469,062** as indicated below:

Selling Price		\$60,000,000
Less:		
Leasehold Mortgages	\$32,301,111	
Owners' Invested Unamortized Equity	\$12,063,478	
Subtotal: Leasehold Mortgage and Owners' Invested Equity		\$44,364,589
Net Proceeds		\$15,635,411
	3% Transfer fee (note 1)	\$469,062

(note 1) - It should be noted that the 3% transfer fee was calculated as of 9/30/16. This amount will need to be recalculated through the closing date of the transaction, which has yet to be determined.

RECOMMENDATION 2: (DREAM)

We recommend that DREAM bill PJG a leasehold transfer fee of \$469,062, subject to adjustment, at the closing of the transaction.

- **DREAM Response:**

We will bill the appropriate transfer fee as of the closing date of the transaction.