

City of Miami

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



Telephone (305) 416-2044

E-Mail: tguba@miamigov.com

August 9, 2017

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

Re: Audit of the Professional Services Agreement between the City of Miami (Melreese Country Club) and Delucca Enterprises
Report No. 17-08

Executive Summary

We have completed an audit of the books and records and selected invoices of vendor services provided by the Melreese Country Club (MCC), as well as the details of revenue and other transactions recorded in the City's accounting system, primarily for the period October 1, 2013 through September 30, 2015.

The audit was performed to determine compliance with the professional services agreement (Agreement) and whether the City of Miami Parks and Recreation Department (Parks Department) sufficiently monitored the operations of the MCC and management services provided by Delucca Enterprises (DE). Annual revenues reported to the City over the audit period were \$2.2 million and \$3.45 million for fiscal year (FY) 14 and FY15, respectively; and there was a net loss of \$592 and a net surplus of \$294,503 for FY14 and FY15, respectively. We reconciled these revenues to DE sales and use tax returns and bank statements and noted no material differences. However, we noted that revenues over the audit period were negatively impacted as a result of golf course renovations that took place during FY14.

Based on the results of our audit, we have concluded that the Parks Department should establish procedures and controls to effectively govern the Agreement between the City and DE as it relates to the management of the MCC. Accordingly, we noted the following:

1. The vendor selection and payment process was not in accordance with best practices.
2. Related party transactions were not disclosed on the CPA Audited Statement of Income.
3. Delucca Enterprises failed to submit an annual budget for the Melreese Country Club operation as required by the Agreement.
4. Credit card revenue was not remitted to the City on a timely basis.

We wish to express our appreciation for the cooperation and courtesies extended to us by all City personnel while conducting this 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
Todd Hannon, City Clerk
Fernando Casamayor, Assistant City Manager/Chief Financial Officer
Nzeribe Ihekwaba, Assistant City Manager/Chief of Operations
Alberto Parjus, Assistant City Manager
Christopher Rose, Director, Office of Management and Budget
Kevin Kirwin, Director, Parks and Recreation Department
Annie Perez, Director, Procurement Department
Erica Paschal, Director, Finance Department
Members of the Audit Advisory Committee
Audit Documentation File

Audit conducted by: Marcus Cabral, CPA, CISA, Senior Auditor
Scarlette Barrios, Staff Auditor

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

**AUDIT OF THE PROFESSIONAL SERVICES AGREEMENT BETWEEN THE CITY OF
MIAMI (MELREESE COUNTRY CLUB) AND DELUCCA ENTERPRISES
OCTOBER 1, 2013 THROUGH SEPTEMBER 30, 2015
REPORT NO. 17-08**

TABLE OF CONTENTS

SCOPE, OBJECTIVES AND METHODOLOGY	1
BACKGROUND.....	2
AUDIT FINDINGS AND RECOMMENDATIONS	3
FINDING 1: THE VENDOR SELECTION AND PAYMENT PROCESS WAS NOT IN ACCORDANCE WITH BEST PRACTICES	3
FINDING 2: RELATED PARTY TRANSACTIONS WERE NOT DISCLOSED ON THE CPA AUDITED STATEMENT OF INCOME.....	5
FINDING 3: DELUCCA ENTERPRISES FAILED TO SUBMIT AN ANNUAL BUDGET FOR THE MELREESE COUNTRY CLUB OPERATION AS REQUIRED BY THE AGREEMENT	6
FINDING 4: CREDIT CARD REVENUE WAS NOT REMITTED TO THE CITY ON A TIMELY BASIS	6

SCOPE, OBJECTIVES AND METHODOLOGY

The scope of the audit included an examination of the Parks Department's procedures and controls as it relates to oversight of the professional services agreement (Agreement) between the City and Delucca Enterprises (DE). The audit primarily covered the period October 1, 2013 through September 30, 2015 and focused on the following objectives:

- To determine whether the City and/or DE complied with the terms of the Agreement.
- To determine whether the appropriate revenues were accurately calculated and remitted to the City.
- To determine whether reimbursement packages submitted to the City by DE were properly reviewed, approved and recorded.
- To determine whether insurance coverage was adequate and in compliance with the terms of the Agreement.
- To determine whether adequate internal controls were maintained.
- To determine whether revenue remittances and other related transactions were recorded in the City's accounting system and deposited into the City's treasury; and
- Other audit procedures as deemed necessary.

We conducted this 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 MCC is a City-owned 18-hole golf course located at 1802 N.W. 37th Avenue, Miami, Florida. It is situated on approximately 160 acres adjacent to the City's Grapeland Park site. In addition to the golf course, the property includes a driving range, two tennis courts, a pro shop and restaurant. Annual revenues reported to the City over the audit period were \$2.2 million and \$3.45 million for FY14 and FY15, respectively; and there was a net loss of \$592 and a net surplus of \$294,503 for FY14 and FY15, respectively. We noted that revenues over the audit period were negatively impacted as a result of golf course renovations that took place during FY14.

In June 2004, the City took over the control and management of the golf course pursuant to a settlement agreement with Bunkers of Miami, a Florida Joint Venture; and, the City entered into an Agreement with Mr. Charlie Delucca to manage the golf course until December 2007. The Agreement was subsequently amended to extend its expiration to September 2008. Then, on August 8, 2008, the Agreement was extended to September 2011 and also authorized the assignment of Mr. Delucca's rights under the Agreement to DE, the company for which he was the sole shareholder and director. Lastly, the Agreement's third amendment, which was effective as of October 1, 2011, extended its term to September 2021, with an option to further extend the Agreement to September 2026.

In its present form, the Agreement stipulates the following:

- Compensation to DE shall equal \$200,000 annually, increased by 3% annually during any fiscal year in which the City's general employees, police employees, fire employees, or sanitation employees receive any cost of living or across-the-board pay increases.
- The City shall also pay DE additional incentive compensation equal to 30% of any Net Operating Surplus derived from the operations beginning with fiscal year ended September 30, 2012. The surplus (if any) is determined annually via an audit performed by a certified public accountant. It should be noted that DE earned incentive compensation for FY15 based on a net operating surplus of \$294,503.

AUDIT FINDINGS AND RECOMMENDATIONS

Overall Conclusion:

Based on the results of our audit, we have concluded that the City's Parks Department should establish procedures and controls to effectively govern the Agreement between the City and DE as it relates to the management of the MCC. Accordingly, we noted the following areas in need of improvement:

1. The vendor selection and payment process was not in accordance with best practices.
2. Related party transactions were not disclosed on the CPA Audited Statement of Income.
3. DE failed to submit an annual budget for the MCC operation as required by the Agreement.
4. Credit card revenue was not remitted to the City on a timely basis.

Details of our findings and recommendations follow:

FINDING 1: THE VENDOR SELECTION AND PAYMENT PROCESS WAS NOT IN ACCORDANCE WITH BEST PRACTICES

According to best practices cited from professional journals related to segregation of duties over vendor approval, "the person who is authorized to approve new vendors should be restricted from approving invoices." These controls can prevent common disbursement schemes such as "shell companies and personal purchases using company funds." New vendors should be adequately verified, documented and approved through the use of "vendor set up forms or requests" before being added to the "vendor master list." "Only one or two employees should have the ability to make changes to the vendor master list and those employees should not have the ability to initiate purchase orders, receive items, approve invoices for payment or sign checks." Periodic reviews should be conducted by an independent person to ensure that unauthorized vendors have not been added to the "vendor master list" or received payments.

The Parks Department has not established policies and procedures to effectively govern the vendor selection, approval and payment process for the MCC. Our audit indicated that the MCC's vendors are not reviewed and approved by the City. According to the Parks Department, the "department has not previously been involved in the selection of vendors used by MCC." The MCC's management company, DE, selects the vendors it utilizes in the operations of the club without any review by the City. In addition to selecting the vendors it utilizes, DE maintains custody of City funds and executes payments to vendors with these funds.

Furthermore, our invoice audit testing disclosed payments to the following vendors that appear to be high risk:

- 1) Bunkers Incorporated (Bunkers), which is controlled/owned by the beneficial owner of DE and a relative who also manages the MCC, sells inventory to the MCC pro shop, sells driving range supplies, and performs tree cutting and repair/maintenance services. Payments to Bunkers totaled \$52,642 over the two-year audit period. These transactions are not at arm's length since DE is able to approve purchases with City funds from a vendor that is controlled by an officer and relative of DE. Basic internal controls are lacking as there is no segregation between authorization, recording and custody of the transactions. Further, there is no independent party that verifies these equipment purchases were actually received, and that the tree cutting or maintenance services were actually performed at the MCC.

- 2) The second entity, Freeze Incorporated (Freeze), has performed major work on the air-conditioning systems at MCC. Payments to Freeze totaled \$42,667 during the audit period. A search of the company's articles of incorporation on the Florida Department of State Division of Corporations website lists three officers for Freeze including a president, vice president and treasurer. We performed a state license search which revealed that none of the three company officers holds a license to perform air-conditioning repair work. However, the company treasurer's status indicated that although he is "eligible for exam" he has not completed the relevant examinations. Our testing also noted that Freeze's invoices for the work performed at MCC and the checks for payment to Freeze do not contain a business address or phone number. We also were unable to obtain a business phone number for Freeze via an internet search, and the "principal place of business address" on Freeze's articles of incorporation lists a personal residence in Hialeah, Florida. We also noted that the listed address for the vice-president of Freeze is nearby the primary residence of a DE principal. Our finding is concerning as the City has not implemented a vendor approval process to ensure vendors are properly vetted prior to being selected to provide services to MCC.
- 3) Our audit revealed that the City does not have documentation evidencing that the independent Certified Public Accountant (CPA) utilized by MCC was selected by both DE and the City as required by the Agreement. We noted that average monthly accounting fees have increased from \$2,472 to \$4,372 from FY11 through FY15, respectively; or from almost \$30,000 to more than \$50,000 per year. These are significant service fees that require a competitive bidding process to ensure that the City is paying the fair market price for services received.

Although DE's Agreement with the City requires compliance with "...local laws, rules, regulations, codes and ordinances," the City Attorney's Office has stated that "Delucca, as an independent private contractor of the City, is not required to comply with the rules and procedures of the City Procurement Code." For example, the code requires that three written quotes be obtained for the purchase of goods/services costing \$2,501 to \$10,000 and five written quotes are required for items that cost \$10,001 to \$25,000. It also requires that, for items that exceed \$25,000, vendors be selected competitively via applicable competitive selection processes (e.g., requests for proposals, invitations for bid, etc.).

However, the City Attorney's Office further stated that "If the City wishes to make any of its contractors or providers subject to compliance under the Procurement Code, the City may do so by amendment to the Agreement with the contractor. Similarly, the City could also amend the Agreement and require Delucca to generally follow the Procurement Code as a goal for larger purchases when engaging in all activities related to the Agreement. An amendment could also accomplish things like disallowing the Provider from buying any good or service from an affiliated or subsidiary business entity."

RECOMMENDATION 1: Parks Department

Since the procurement and payment processes at MCC are executed with City funds, we recommend that the City of Miami Parks Department, in coordination with the Procurement Department, establish and implement policies and procedures to govern/control the vendor selection and payment process in accordance with best practices. A complete review of all vendors utilized by DE should be performed to ensure that only established, licensed and insured vendors are hired to perform work on City-owned property. Alternatively, as the City Attorney's Office proposes, the City may achieve these goals by amending the Agreement with the contractor to require compliance with the Procurement Code, or implement other procedures to preclude a recurrence of the previously-cited or other potential exceptions.

- **Parks Response:**
We will meet with Procurement professionals to establish general language regarding best practices and processing techniques within industry standards for the vendor selection and payment process.
- **Implementation Date:**
January 2018

FINDING 2: RELATED PARTY TRANSACTIONS WERE NOT DISCLOSED ON THE CPA AUDITED STATEMENT OF INCOME

According to FASB (Financial Accounting Standards Board) Codification 850, financial statements shall include disclosures of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. The disclosures shall include; 1) The nature of the relationship(s) involved, and; 2) A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements.

The external CPA audited statement of income for MCC did not disclose that there were related party transactions during fiscal years 2014 and 2015.

As previously noted, our audit indicated that MCC made purchases and paid for services provided by Bunkers, an entity that is owned and controlled by the beneficial owner of DE and a relative who also manages the MCC. The transactions were material when compared to the total disbursements for each period in the respective income statement categories. For example, during FY15, DE's pro shop merchandise/driving range supplies purchases from Bunkers were 13% (\$22,652) of the total purchases (\$169,616) and repair/maintenance service expenses were 17% (\$7,623) of the category totals (\$44,096). During FY14, pro shop merchandise/driving range supplies purchases from Bunkers were 16% (\$14,624) of total purchases (\$91,376) and repair/maintenance service expenses were 88% (\$7,743) of the category totals (\$8,789).

RECOMMENDATION 2: Parks Department

If related party transactions are permitted after being properly vetted via procurement policies and procedures, they should be disclosed; if applicable, in accordance with accounting standards.

- **Parks Response:**
In the Statement of Income and Supplementary Information for the Year Ended September 2016, the currently selected Independent Certified Accountant included the following under Notes to Financial Statement, Transactions with Affiliate: Management purchases its range golf balls from and contracts an affiliate, related by common ownership, for the trimming of the golf course trees and other maintenance. The Parks and Recreation Department will continue to require this disclosure as part of the annual audited statement prepared by the Independent Certified Accountant.
- **Implementation Date:**
Action has already been implemented with Fiscal Year 2016 audited statement.

FINDING 3: DELUCCA ENTERPRISES FAILED TO SUBMIT AN ANNUAL BUDGET FOR THE MELREESE COUNTRY CLUB OPERATION AS REQUIRED BY THE AGREEMENT

According to best practices, budgets are planning tools and can also serve a valuable control function. When adopted before the beginning of the next fiscal year, it becomes the benchmark against which financial reporting should be compared.

Section 5 of the Agreement between the City and DE (Commission approved on 7/26/2012) states that “Provider shall prepare and submit to the City Manager on or before February 28th preceding each fiscal year a budget request pertaining to operating and capital expenditures for the Golf Course Facilities, which request shall not be implemented until approved by the City Manager. Provider shall be prohibited from incurring any expenditures not specifically approved in the budget other than any ordinary and necessary expenses (such as cost of goods or services sold and labor cost) paid or incurred because actual revenues have exceeded or will exceed revenues as projected in the budget request.”

DE did not submit an annual budget for FY14 and FY15 to the City Manager as required by the Agreement. The absence of an annual budget raises the risk of inefficient use of City resources. The first annual budget prepared and submitted to the City was for FY16. However, according to the City’s Oracle Accounting System, MCC’s actual FY16 expenditures exceeded budgeted amounts by 16.1% (\$3,490,629 vs. \$3,007,200) and revenues fell short of targeted amounts by 4.8% (\$3,596,300 vs. \$3,422,388). We noted that the Parks Department Deputy Director informed DE in writing on August 24, 2016 that actual expenditures through the 10 months ended July 2016 were within \$264,798 of the yearly budgeted amount of \$3,007,280. However, MCC did not restrain spending, which resulted in annual expenses exceeding the budget by \$483,429, or 16.1% as shown above.

RECOMMENDATION 3: Parks Department

We recommend that City management require DE to prepare and submit an annual budget for approval. DE should adhere to the budget to ensure that public monies are spent appropriately.

- **Parks Response:**
For FY16, FY17 and FY18 the Parks and Recreation Department provided to Delucca Enterprises the format in which to submit their budget request with instructions to submit their fiscal year request prior to February 28th of the current year. DeLuca Enterprises has complied with this requirement and the Parks and Recreation Department has submitted the Melreese Country Club budget in the same format as all other departments follow for consideration during the annual budget process.
- **Implementation Date:**
Budget process is currently compliant with Professional Services Agreement.

FINDING 4: CREDIT CARD REVENUE WAS NOT REMITTED TO THE CITY ON A TIMELY BASIS

The amounts of revenues generated from MCC operations that are paid with credit cards are reported to the City on a daily basis. We noted that in lieu of these revenues being deposited into a City bank account via the use of a City credit card “merchant code” number, monies from these transactions are deposited into a DE bank account. According to the City’s Oracle Accounting System, FY14 revenues generated from credit cards totaled \$1.48 million, or 68% of revenues totaling \$2.2 million; and, during FY15, credit card revenues totaled \$2.41 million, or 70% of revenues totaling \$3.45 million. As a result, the City must record these revenue amounts as an account receivable (amount due to the City) at the end of the month.

Additionally, instead of turning these revenues (general fund monies) over to the City immediately upon collection, DE uses the monies to cover expenses that arise from operating the MCC site including employee salaries, utilities and supplies. Once these expenses are paid, DE submits an expense reimbursement support package to the City's Parks Department for review. After approval, the Parks department authorizes the Finance department to release these monies back to MCC. If MCC has adequate cash on hand after receiving reimbursement, monies are then turned back over to Finance to reduce the account receivable balance.

However, there are inadequate controls to assure that DE utilizes City funds only for allowable ordinary and necessary expenses incurred in their normal operation. Our audit of the expense reimbursement support packages revealed that DE used cash on hand for operations to fund onsite capital improvement projects and landscape projects/work at other City parks. During FY14 through FY16, MCC funded, with golf course revenues (general fund monies), onsite property remediation work totaling \$1.36 million, including \$476,334 during FY16; and, landscape work at Hadley Park totaling \$22,275. We also noted that MCC's audited financial statements disclosed "maintenance and repairs" expenses at "City Parks" (parks other than MCC) for FY14 and FY15 of \$108,550 and \$107,800, respectively. These projects were paid initially with general fund monies and were not procured through capital project bidding procedures established in the City's Procurement Code. Using MCC revenues for these purposes has resulted in recurring cash flow management issues, and led to MCC falling significantly behind on paying amounts due to the City. During the seven months ended September 30, 2016, MCC had an average outstanding balance due to the City of \$723,875 with monthly outstanding balances ranging from \$503,117 to \$984,356.

RECOMMENDATION 4: Parks Department

To correct these deficiencies, we recommend that:

1. The City, subject to Commission approval, make a one-time capital contribution to MCC to be used as an imprest fund. These funds should be used to create an operating account that will be only used to pay for MCC operating expenses—not capital project or major repair expenses; and, a payroll account, which will be used to pay for MCC wages/salaries and payroll taxes. The amount to be funded should be based on an analysis of their operating/payroll expense and reimbursement history.
 2. Unless adequately controlled by another acceptable method, all credit card transactions should be processed using a City-designated credit card merchant code so that all such transactions are deposited directly into a City bank account. These funds can be used to periodically replenish MCC operating and payroll accounts as needed; however, such cash needs should be controlled and supported by timely prepared cash flow documentation.
 3. MCC capital project and major repair expenses should require prior written approval by the City and be paid with properly authorized capital project funds (along with appropriate vendor selection procedures as described in Recommendation 1, page 4).
- **Parks Response:**
 1. The Parks and Recreation Department will work with the Office of Management and Budget and Department of Finance to identify the mechanism to establish an imprest fund. This will require amending the current Agreement to establish policies and procedures regarding the utilization of the imprest fund and associated changes in the depositing of credit card transactions.

2. Finance Department and the Chief Financial Officer (CFO) will work with DeLuca Enterprises to establish and secure best practices, policies and procedures to ensure credit card proceeds are remitted within 30 days.
 3. The Parks and Recreation Department will request from DeLuca Enterprises as part of the annual budget proposal, any capital needs for the Melreese Country Club, to be submitted in the same manner of all capital requests for City departments. If funded, we will establish as part of the amendment to the Professional Services Agreement, the mechanism for expenditures of approved capital improvements.
- **Implementation Date:**
January 2018