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CITY OF CORAL GABLES, FLORIDA

Internal Audit of Specific Land Lease Agreements

January 2021

Distribution:
Mayor and City
Commissioners

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EXECUTIVE SUMMARY

Overview

Crowe LLP (“Crowe” or “we”) performed internal audit procedures related to the land lease agreements between the City of Coral Gables and The Palace Management Group and Coral Grand, LLC. The objective of the procedures was to test if the Palace Management Group and Coral Grand, LLC are paying the City the proper rental payments as outlined in the agreements. Crowe read policies, procedures, and contracts, conducted interviews with personnel, and recalculated payments.

Summary of Results

The following is a summary of our observations as a result of our procedures. We listed the opportunity for improvement and corresponding risk rating.

Process	Observation #	Opportunity for Improvement	Risk Rating**
Sales Tax	1	The City should ensure the correct sales tax is used for invoicing.	Moderate
Timeliness of Payment of Percentage Base Rent Payment	2	The City should ensure that the collection of the percentage base rent payment is timely and adheres to the agreements.	Low
Policies and Procedures	3	The City should have formal written policies and procedures.	Low
Financial Statements	4	The City should follow-up on Lessees who have not provided their financial statements.	Moderate

**For explanation of *Risk Rating* determination, refer to page 5.

INTRODUCTION

Background

The City of Coral Gables (the “City”) has entered into lease agreements with Coral Grand, LLC (“Coral Grand”) and The Palace Management Group, LLC (“Palace”) (collectively the “Lessees”) where, in exchange for the lease of the land, the Lessees agree to pay the City rental payments and a percentage of their gross annual revenues as a percentage of base rent.

Objective and Scope

The objective of the procedures performed was to evaluate and test the design and effectiveness of selected internal controls, and to see if policies and procedures were being properly followed. In summary, this internal audit evaluated the following:

- Assess if the internal controls surrounding oversight of the agreements and receipt of payments are designed effectively.
- Determine if the Lessees are paying the City the proper rental payments as outlined in the agreements.
- Determine if there are any improvements to be implemented in order to ensure accurate reporting between the Lessees and the City.

The detailed procedures performed can be found starting on page 6 of the report.

Although our testing was performed in some areas without exception, we can provide no assurance that exceptions would have been detected had procedures been changed or expanded.

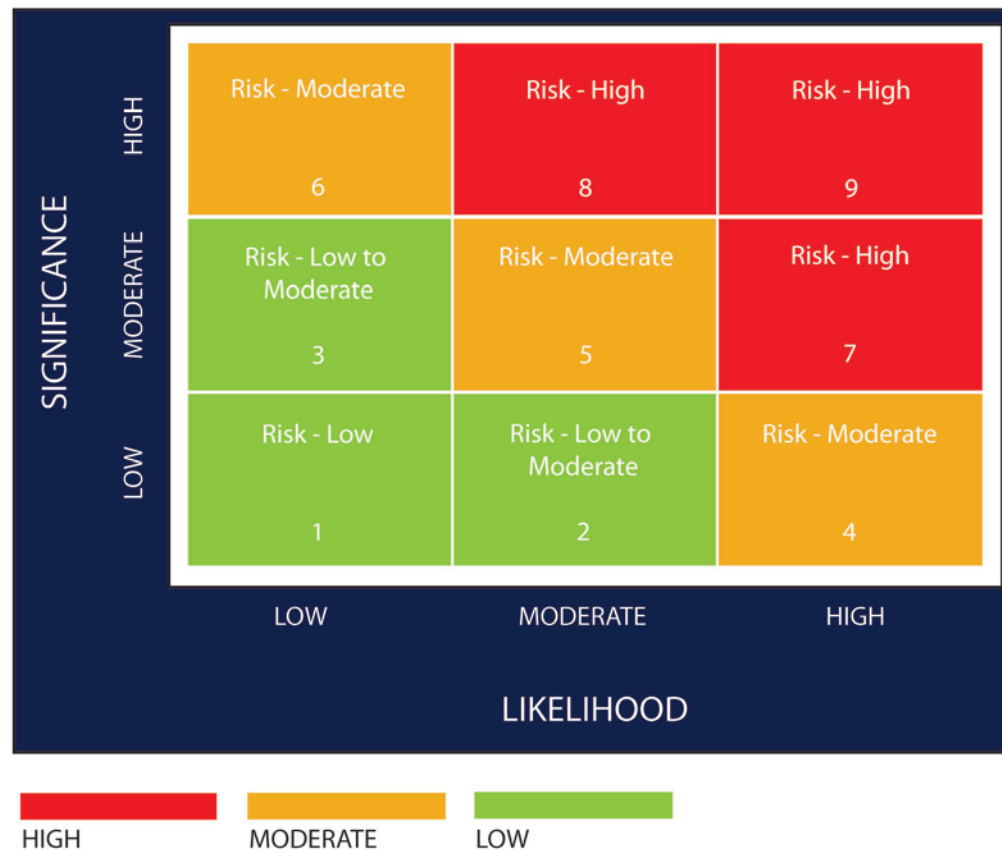
It should also be recognized that internal controls are designed to provide reasonable, but not absolute, assurance that errors and irregularities will not occur, and that procedures are performed in accordance with management’s intentions. There are inherent limitations that should be recognized considering the potential effectiveness of any system of internal controls. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes on judgment, carelessness and other factors.

Internal control procedures can be circumvented intentionally by management with respect to the execution and recording of transactions, or with respect to the estimates and judgments requirement in processing of data. Controls may become ineffective due to newly identified business or technology exposures. Further, the projection of any evaluation of internal control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with procedures may deteriorate.

INTRODUCTION

Risk Management

Risks are evaluated based on its “significance” to management’s strategy and its “likelihood” to occur. This will result in a risk profile of the highest risks to the organization as presented below:



PROCEDURES PERFORMED

PROCEDURES PERFORMED	RESULTS
<u>General Operations</u>	
1) Review the policies and procedures in place surrounding oversight of the land lease agreements.	<p>Crowe requested formal policies and procedures surrounding the land lease agreements.</p> <p>Refer to Opportunity for Improvement 3.</p>
2) Gain an understanding, through communications with management and key personnel, of the internal operations and document internal controls over key procedures.	<p>Crowe performed interviews and discussions over the course of the audit. Interviews were held with key personnel within the City.</p> <p>Our understanding of policies and procedures were reviewed and tested throughout all aspects of the audit.</p>
<p>3) To determine if payments sent to the City from the Lessees were accurate, Crowe performed the following:</p> <p>a) Obtained the last eight payments received by the City.</p> <p>b) For the eight payments selected, Crowe tested if:</p> <p>i) Rent and sales tax was calculated correctly.</p> <p>ii) Payments agreed to the invoice.</p>	<p>During our testing we noted that the incorrect sales tax percent was applied when invoicing both lessees.</p> <p>Refer to Opportunity for Improvement 1.</p> <p>During our testing we noted that Palace pays the percentage base rent payment to the City annually, instead of semiannually as required by the agreement.</p> <p>Refer to Opportunity for Improvement 2.</p> <p>During our testing we noted that Coral Grand had not provided their most recent financial statements in order to invoice the percentage base rent.</p> <p>Refer to Opportunity for Improvement 4.</p>

OBSERVATIONS AND RECOMMENDATIONS

1. OPPORTUNITY FOR IMPROVEMENT – Percentage of Sales Tax Collected: MODERATE RISK

State sales tax is required to be collected from the Lessees by the City. During our recalculation of the sales tax invoiced from January through November 2019, it was noted that the incorrect sales tax percentage was being used. The correct sales tax rate was 6.7% as opposed to the 6.8% used by the City for invoicing. In our follow up procedure, we noted that the overcharged sales tax collected during the period from January through November 2019 was credited on the December 2019 invoice for both Lessees.

Recommendation: We recommend that the City implement a control to review state sales tax percentages as published by the Florida Department of Revenue on an annual basis and adjust sales tax calculations accordingly. A review of the invoice calculations should be completed by someone independent of preparing the calculation on a regular basis to ensure accuracy.

Management Response/Action Plan: The City agrees with the audit recommendation. The City will implement a process whereby all City leases will be reviewed in January of each year to adjust the sales tax calculations accordingly. This process will be performed by someone other than the individual preparing the billing.

2. OPPORTUNITY FOR IMPROVEMENT – Timeliness of Payment of Percentage-Based Rent Payments: LOW RISK

In accordance with Section 2.5(b) of the Palace agreement, Palace is required to pay the City a percentage of their annual revenues on a semiannual basis. Upon review of the payment support, it was noted that the Lessee was paying the City the entire amount annually.

Recommendation: We recommend that the City consider invoicing the Lessee for the percentage-based rent semiannually instead of annually. Collecting the percentage-based rent semiannually instead of annually is stipulated in the agreement and could improve the City's cash flow.

Management Response/Action Plan: In 2020, the City implemented semiannual request and invoicing of the Palace's financial statements and the collection of percentage-based rent. In 2020, the Palace paid percentage rent both in February and September of 2020 as stipulated in their agreement with the City.

3. OPPORTUNITY FOR IMPROVEMENT – Documentation of Formal Policies and Procedures: LOW RISK

During our initial interviews with the City, it was discovered that there were no formal written policies and procedures in place at the City for land lease agreement monitoring. Subsequently, a formal policies and procedures document was completed and provided during the period of our audit.

OBSERVATIONS AND RECOMMENDATIONS

Recommendation: We recommend that the City regularly monitor the newly developed policy for necessary updates. Formally documented policies and procedures will establish clear guidelines as to how employees should perform tasks, ensure compliance with the terms of the agreements and provide for an independent review of the calculations.

Management Response/Action Plan: In 2020, the Economic Development and Finance Departments worked together to establish policies and procedures that established clear guidelines as to how employees should perform tasks, ensure compliance with the terms of the agreements and provide for an independent review of the financial statements and calculations submitted by tenants.

4. OPPORTUNITY FOR IMPROVEMENT – Reviewed Financial Statements: MODERATE RISK

Section 11.B.1 of the land lease agreement with Coral Grand includes a section whereby the Lessee is required to deliver to the City their unaudited financial statements reviewed by a certified public accounting firm within 90 days after the end of each year of operations and the certified public accounting firm shall certify to the amount of gross revenues from Coral Grand. The reviewed financial statements are used by the City to examine the computation of the percentage base rent and transaction rent.

The City requested the 2019 financial statements from Coral Grand on February 18, 2020. Coral Grand submitted their financial statements on March 10, 2020. However, they were not reviewed by a certified public accounting firm. The City rejected the financial statements and Coral Grand subsequently provided their reviewed financial statements on June 17, 2020.

Recommendation: We recommend that the City include in the written policies and procedures steps to be taken to ensure timely receipt of the reviewed financial statements from Coral Grand in order to verify that the correct payments are being remitted to the City in a timely manner.

Management Response/Action Plan: In 2020, the Economic Development and Finance Departments worked together to establish policies and procedures that established clear guidelines to ensure timely receipt of the reviewed financial statements from Coral Grand in order to verify that the correct payments are being remitted to the City in a timely manner.