MIAMIBEACH

INTERNAL AUDIT REPORT

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Office of Internal Audit
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TO: Jimmy L. Morales, City Manager
VIA: Mark D. Coolidge, Interim Internal Auditor MDC
FROM: Jessica Romero, Auditor J.R.L

DATE: July 18, 2018
AUDIT: Deco Bike, LLC Concession Agreement Audit
PERIOD: October 1, 2012 through February 28, 2018

This report is the result of specific request made by the City's Parking Department to verify compliance with selected provisions of the concession agreement between the City and Deco Bike, LLC to provide and operate a Citywide self-service bicycle rental program. This audit primarily focused on 1) re-calculating the Windfall Provision and reviewing the source documents provided to ensure that all tested revenues and expenses were properly allocated to the City; 2) re-calculating the Windfall Provision Cap; and 3) determining whether tested concession fees were accurately calculated and timely submitted.

INTRODUCTION

On July 15, 2009, the City entered into an agreement with Deco Bike, LLC (concessionaire) in response to Request for Proposal No. 44-07/08 for the delivery and operation of a self-service bicycle rental fleet for public use to be stationed in the public rights-of-way. The agreement required the concessionaire to implement a program which enables the public to self-rent bicycles from any or a number of locations and return them to another location, on a 24-hour, 365 day a year basis. Thereafter, it became evident to the Administration that without intervention by the City, either through a contract term modification or additional revenue source, the program would not achieve a return of capital or modest profit to the concessionaire, or recover the City's forgone parking revenues over the long term.

On July 18, 2012, the Mayor and City Commission adopted Resolution No. 2012-27975, accepting the recommendation of the City Manager to amend the agreement, based upon the approved terms, and authorizing the City Manager and the City Attorney's Office to negotiate and draft amendment no. 1 to the agreement, dated December 16, 2013. Among other modifications, this amendment extended the terms for an additional ten years through September 30, 2023; increased the bicycle fleet from 900 to 1,100; permitted advertising on the bicycle's basket though a Sponsorship Program; approved advertising on designated kiosks; and provided for a revenue sharing provision, including a return of capital and the Windfall Provision.

Furthermore, amendment no. 2 to the agreement, dated May 12, 2015, included an advertising sponsorship proposal agreement between Citibank and the concessionaire, dated June 7, 2014 ("Citibank Sponsorship Agreement"), over a term of five (5) years, with an initial base sponsorship budget of $750,000, and with five percent (5%) annual escalators. The City and the concessionaire agreed that the advertising revenues generated from the Citibank Sponsorship Agreement would be shared with the City, as part of the Bicycle Basket Sponsorship Program

and the Kiosk Advertising Program retroactively effective to November 1, 2014. Also, the Citibank Sponsorship Agreement provides for the replacement of the existing bicycles with new bicycles containing the Citibank brand, "Citi Bike"; advertising on the kiosks and revenues connected with advertising using the name Citi Bike; and which sponsorship agreement would improve the quality of the bicycles and generate more revenue for the concessionaire and the City, as more particularly set forth herein.

OVERALL OPINION

Deco Bike, LLC (concessionaire) has been diligent in maintaining the concession areas as well as consistently addressing equipment repair issues (i.e. bicycles, docks, kiosks, etc.) through periodic inspections. Despite these positive attributes, the following deficiencies were noted during testing that are in need of corrective action:

1. The Office of Internal Audit's February 28, 2018 Windfall Provision calculations determined that the concessionaire is at $2,396,114.57, which is $1,318,885.43 below the $3,715,000 threshold which triggers the City receiving an increased share of the net profits. Both the concessionaire and the City's Parking Department have agreed to this figure which is to serve as the basis for future calculations.

2. The concessionaire understated sponsorship revenues resulting in a $78,404.46 underpayment to the City which has since been paid in full.

3. The Parking Department verbally agreed to a material term change with the concessionaire without first executing an amendment to the agreement that was approved by the City Commission.

4. Improvements are necessary to the concessionaire's books and accounting records to comply with requirements of the agreement.

SCOPE, OBJECTIVES, AND METHODOLOGY

The scope of this audit was to determine the level of compliance with selected provisions of the Deco Bike, LLC concession agreement. The audit covered the period from October 1, 2012 through February 28, 2018, and various transactions as needed made prior and subsequent to this period. This audit focused primarily on the following objectives:

- determining whether concession fees were accurately calculated and timely submitted;
- confirming compliance to other selected concession agreement provisions;
- re-calculating the Windfall Provision and reviewing the source documents to ensure that all revenues and expenses were properly allocated to the City; and
- re-calculating the Windfall Provision Cap.

We conducted this performance audit in accordance with the Standard Operating Procedures of the City of Miami Beach's Office of Internal Audit as well as internal audit best practices. Those require that we plan and perform the audit to obtain sufficient, appropriate evidence 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:

- reviewed applicable provisions within the concession agreement entered to by the City of Miami Beach and Deco Bike, LLC;
- interviewed and made inquiries of City and Deco Bike, LLC personnel to gain an understanding of the internal controls (relative to the operations of self-service bicycle rental program), assess control risk, and plan audit procedures;
- performed substantive testing consistent with the audit objectives, including but not limited to examination, on a sample basis, of applicable transactions and records;
- drew conclusions based on the results of testing, made corresponding recommendations, and obtained auditee responses and corrective action plans; and,
- performed other audit procedures as deemed necessary.

FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Finding: *The Office of Internal Audit's February 28, 2018 Windfall Provision Calculations Determined that Deco Bike, LLC is at $2,396,114.57 which is $1,318,885.43 Below the $3,715,000 Threshold which Triggers the City Receiving an Increased Share of the Net Profits*

   Section 11 of amendment no. 1 to the concession agreement summarized states that should the Deco Bike, LLC's (concessionaire) operations provide a return of their capital investment ($3,715,000) prior to September 30, 2023, the City shall receive a fifty percent (50%) share of the annual net income in excess of concessionaire's three percent (3%) profit each year until the end of the term of the agreement.

   Furthermore, once this Windfall Provision reaches the $3,715,000 threshold, the return to the City will be capped at the sum of 1) all revenues exempted from the City share calculation including the following: a) sum of annual credit card/merchant processing fees; and b) the exempted revenues beginning on October 1, 2012 and declining at the rate of $250,000 per year through September 30, 2018; as well as 2) the revenue exempted during the first contract year of operations of (as provided in the original concession agreement between the parties with an effective date of July 15, 2009); and 3) the

cumulative difference, if any, between the foregone revenues of $3,000 per parking space occupied by the concessionaire's equipment [estimated at approximately ninety (90) parking spaces], and the City's cumulative revenue share on memberships and rentals fees during the term or the agreement.

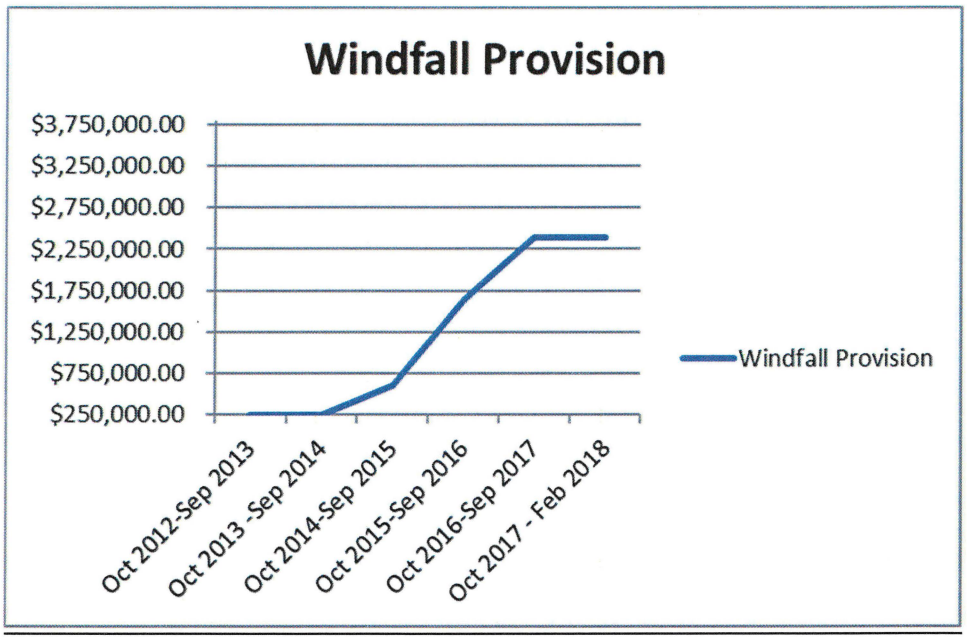
To determine whether the Windfall Provision had been reached, all gross revenues generated by the concessionaire during the October 1, 2012 through February 28, 2018 audit period were reviewed. In addition, all 2015/16 fiscal year allowable expenses (i.e. labor, leases, utilities, office expenses, commissions, supplies, advertising, depreciation, freight communication, insurance, vehicle, internet, and bike parts) as well as various other expense accounts from the other fiscal years in the October 1, 2012 through February 28, 2018 audit period were reviewed.

As a result, it was determined that the concessionaire's return on capital through February 28, 2018 totaled $2,396,114.57 as shown in the schedule below which slightly differed from the Parking Department's calculations due to several factors. In addition, the concessionaire relied on the City's figures so its accuracy takes on added importance. Consequently, it was calculated that the Windfall Provision had not yet been reached by $1,318,885.43 ($3,715,000 - $2,396,114.57) as of February 28, 2018 (the end of the audit period).

Summary & Analysis of Windfall Provsion

Period from October 1, 2012 through February 28, 2018

Period	Gross Revenues	Expenses	Net Income	3% Profit	Windfall Provision
Oct 2012-Sep 2013	$ 3,421,412.39	$ 3,059,026.85	$ 362,385.54	$ 111,450.00	$ 250,935.54
Oct 2013 -Sep 2014	$ 3,302,676.74	$ 3,382,306.42	$ (79,629.68)	$ -	$ -
Oct 2014-Sep 2015	$ 3,928,995.90	$ 3,471,190.96	$ 457,804.94	$ 111,450.00	$ 346,354.94
Oct 2015-Sep 2016	$ 4,483,375.06	$ 3,323,852.72	$ 1,159,522.34	$ 111,450.00	$ 1,048,072.34
Oct 2016-Sep 2017	$ 4,298,748.61	$ 3,436,546.85	$ 862,201.76	$ 111,450.00	$ 750,751.76
Oct 2017 - Feb 2018	$ 1,684,740.08	$ 1,637,065.03	$ 47,675.05	$ 47,675.05	$ (0.00)
TOTAL	**$ 21,119,948.78**	**$ 18,309,988.84**	**$ 2,809,959.94**	**$ 493,475.05**	**$ 2,396,114.57**



As part of our Windfall Provision Cap calculation analysis, the Office of Internal Audit obtained and reviewed the merchant statements' fees, the exempted revenues as per section 11 of amendment no. 1 to the concession agreement and calculated the cumulative difference between the forgone revenue (i.e. $3,000 x 90 parking spaces) and the City's cumulative revenue share on memberships and rental fees during the audit period. Results from our testing disclosed that the Windfall Provision Cap as of February 28, 2018 totaled $1,021,319.70 as shown below.

Windfall Provision Cap

Period from October 1, 2012 through February 28, 2018

Forgone Revenues	Oct 2012-Sep 2013	Oct 2013-Sep 2014	Oct 2014-Sep 2015	Oct 2015-Sep 2016	Oct 2016-Sep 2017	Oct 2017-Feb 2018	Total
Merchant Fees	$ 18,481.89	$ 19,295.95	$ 19,354.67	$ 22,143.91	$ 25,966.36	$ 10,987.91	$ 116,230.69
Concessionaire Revenue Exempt-Merchant	$ 179,460.00	$ 150,000.00	$ 103,087.65	$ 90,000.00	$ 32,236.18	$ 23,133.76	$ 577,917.59
Concessionaire Revenue Exempt-Sponsorship	$ 755.78	$ -	$ 23,670.24	$ -	$ 38,857.78	$ 9,609.87	$ 72,893.67
Revenue Exempt during first year 2009	$ -	$ -	$ -	$ -	$ -	$ -	$ 120,000.00
Parking Space	$ 73,890.16	$ 60,387.59	$ -	$ -	$ -	$ -	$ 134,277.75
						TOTAL	**$ 1,021,319.70**

Recommendation(s):
The Parking Department should continue to closely monitor the concessionaire's revenues and allowable expenses to update the Windfall Provision amount and the cap going forward. As both the Parking Department and the concessionaire agreed to these figures, it should serve as the basis for all future calculations based on the concessionaire's subsequently reported figures that are to be verified annually by an independent CPA firm (see finding #4). Once the Windfall Provision is met, the City should promptly calculate the amount due (i.e. fifty percent (50%) of annual net income in excess of the concessionaire's three percent (3%) profit) at year end.

Management Response (Parking Department):
The Parking Department has been monitoring the Windfall Provision and will continue to update as needed.

Implementation Date: July 9, 2018

2. Finding: *The Concessionaire Understated Sponsorship Revenues Resulting in a $78,404.46 Underpayment to the City*
As per Section 4.1 of amendment no. 1 to the concession agreement, commencing on October 1, 2012, the City's revenue share is to be calculated as follows:

(1) an amount equal to twelve percent (12%) of gross sales, based on concessionaire's gross sales receipts **up to $3,000,000**, net of sales tax and merchant processing fees, shall become due and payable by concessionaire to the City within fifteen (15) days following the end of each calendar month during each contract year throughout the term.
(2) an amount equal to fifteen percent (15%) of gross sales, based on concessionaire's gross sales receipts **greater than $3,000,000**, net of sales tax and merchant processing fees, shall become due and payable by concessionaire to the City within fifteen (15) days following the end of each calendar month during each contract year throughout the term.
(3) an amount equal to twenty five percent (25%) of gross sales of concessionaire's Bicycle Basket Sponsorship Program shall become due and payable by concessionaire to the City fifteen (15) days following the end of each calendar month during each contract year throughout the term.
(4) the concessionaire will be permitted to place advertising on up to forty (40) kiosks. The City shall receive 12% of the gross revenues on kiosk advertising.

To ensure whether the concessionaire's revenue share was accurately calculated and timely submitted to the City, all monthly bank statements and merchant statements for the period of October 1, 2012 through February 28, 2018 were reviewed. In addition, sponsorship related invoices submitted by the concessionaire to Citibank on a quarterly basis for the period of November 1, 2014 through February 28, 2018 were analyzed to ensure that the corresponding payments remitted to the City were timely and correct.

As a result, it was determined that the City was underpaid by $78,404.46 mostly due to a quarterly credit of $50,000 being incorrectly applied before calculating the sponsorship revenue share. This $450,000 total deficiency occurred ($50,000 x 9 quarters starting with quarter 4 of 2015) because the sponsorship share was being mistakenly calculated using the deposit register on the bank statement instead of the amount billed to Citibank.

Without this additional information, City staff would not have been able to determine that additional monies were owed. As a result, the concessionaire's figures and corresponding true-up payments for 2015, 2016 and 2017 were reviewed and approved despite the unreported revenues. A Finance Department staff member was assigned the responsibility to review the concessionaire's calculations through March 2017 based on the documentation provided. This task was subsequently transferred to the Parking Department where it has remained since.

The following table summarizes the calculations from which the $78,404.46 underpayment was derived:

RECAP			
YEAR	Amount paid to the City (As per EDEN/Munis)	Amount due to the City (as per Internal Auditor)	Difference (add'l amount owe to City)
2012-2013	$ 406,091.41	$ 194,984.84	$ 211,106.57
2013-2014	$ -	$ 209,612.41	$ (209,612.41)
2014-2015	$ 333,672.14	$ 352,031.71	$ (18,359.57)
2015-2016	$ 380,993.28	$ 410,895.85	$ (29,902.57)
2016-2017	$ 403,476.56	$ 419,040.46	$ (15,563.90)
2017-2018	$ 184,925.71	$ 200,998.29	$ (16,072.58)
		Total amount owe to City	(78,404.46)

Recommendation(s):
The Parking Department should create a City Bill invoicing the concessionaire for the $78,404.46 underpayment as of February 28, 2018. Furthermore, the concessionaire should begin submitting copies of their quarterly sponsorship invoices to the City's Parking Department to help ensure that the sponsorship share revenue is being properly calculated.

Management Response (Parking Department):
The Parking Department immediately invoiced the concessionaire and the invoice has already been paid. In addition, the Parking Department is already receiving the quarterly sponsorship invoice from the concessionaire.

Implementation Date: July 9, 2018

Management Response (Finance Department):
The City generated a City Bill for $78,404.46 on May 8th, 2018. Deco Bike paid the invoice on May 10, 2018.

Implementation Date: May 8th, 2018

Concessionaire's Response (Deco Bike, LLC):
On May 8, 2018 Deco Bike, LLC confirmed and accept the incorrect calculation and paid the $78,404.46 as per invoice #13810 with check #215.

Implementation Date: May 8, 2018

3. Finding: *The Parking Department Verbally Agreed to a Material Term Change with the Concessionaire without First Executing an Amendment to the Agreement that was Approved by the City Commission*
Section 21.2 states that the agreement cannot be changed or modified except by agreement in writing executed by all parties hereto. Concessionaire acknowledges that no modification to this agreement may be agreed to by the City unless approved by the Mayor and City Commission except where such authority has been expressly provided herein to the City Manager or his designee.

Exhibit 16.6 of amendment no. 2 to the concession agreement is silent on whether the City is entitled to receive a share of naming rights. However, starting in October 2014, based on financial records reviewed, as well as email communication received from the Parking Department, the concessionaire agreed to pay the City 25% of their 50% naming rights share. During the period of October 2014 through February 2018, the City has received a total of $172,950.61 for its naming rights share. Although this arrangement was mutually approved, its terms were not presented to the Mayor and City Commission for approval.

Recommendation(s):
The Parking Department should prepare an amendment of the agreement to include the additional City revenue share related to naming and rights. Similarly, any additional future changes should be approved by the City Commission before any stated terms are amended.

Management Response (Parking Department):
The Parking Department will ensure that the next amendment includes the clarification of the naming rights as well as any other changes.

4. Finding: *Improvements are Necessary to the Concessionaire's Books and Accounting Records to Comply with Requirements of the Agreement*

As per Section 5 of the agreement, the concessionaire shall maintain current, accurate, and complete financial records (on an accrual basis) related to its operations herein. Systems and procedures used to maintain these records shall include a system of internal controls and all accounting records shall be maintained in accordance with general accepted accounting principles. Such records and accounts shall include, at a minimum, a breakdown of gross receipts, expenses, and profit and loss statements".

Furthermore, Section 6 states that the "Concessionaire shall submit at the end of each contract year (throughout the term), an annual statement of gross receipts, in a form consistent with generally accepted accounting principles. Additionally, such statement shall be accompanied by a report from an independent C.P.A. firm".

Testing showed that the concessionaire's financial records contained mistakes mostly due to accounting errors. For example, it was noted that the financial records were maintained on a cash basis instead of an accrual basis as required in the agreement; and $800,000 received as an advance/loan from Citibank was to be paid back in full over the remaining term of the agreement was incorrectly recorded as income instead of as a liability. Furthermore, it was noted that expenses were registered in the incorrect accounts (reclassified from supplies to bike parts of $21,536), duplication of labor expenses in management (S. Alvarez $43,000), incorrect depreciation calculations, etc. These corrections were included in the Windfall Provision calculations made by the Office of Internal Audit in finding #1.

Recommendation(s):

The concessionaire's monthly financial records should be prepared and/or reviewed by a qualified accountant to better ensure the accuracy and completeness of the reported data. Also, the annual statement should be accompanied by a report from an independent C.P.A. firm so that the City can rely on its accuracy and completeness in determining the Windfall Provision calculations.

Concessionaire's Response (Deco Bike, LLC):

Based on the findings of the audit, we will implement the recommendations as soon as possible. I am in the process of looking for a bookkeeper internally and will start forwarding on a monthly basis the financials to our CPA for review to make sure all the expenses are classified correctly.

EXIT CONFERENCE

An exit conference was held in the Parking Administration's Conference Room on June 28, 2018. Participants included Saul Frances (Parking Director), Laura Franco-Rubines (Assistant Director Parking Services Compliance), Charles Dike (Senior Management Analyst), Rocio Alba (Administrative Services Manager), Mark Coolidge (Interim Internal Auditor) and Jessica Romero (Auditor). Management responses were solicited and included above. All parties were in agreement as to the contents of this report.

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cc: Kathie G. Brooks, Assistant City Manager
John Woodruff, Chief Financial Officer
Saul Frances, Parking Director
Bonifacio Diaz, Owner, Deco Bike, LLC