

INTERNAL AUDIT REPORT

CITY OF MANCHESTER

NEW HAMPSHIRE



Derryfield Country Club Restaurant

Contract Compliance Audit

December 2011

Prepared by

City of Manchester, NH

Office of the Independent City Auditor

**INTERNAL AUDIT REPORT
CITY OF MANCHESTER, NEW HAMPSHIRE
DERRYFIELD COUNTRY CLUB RESTAURANT
CONTRACT COMPLIANCE AUDIT
DECEMBER 2011**

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March 16, 2012

Committee on Accounts, Enrollment and Revenue Administration
City of Manchester, New Hampshire
Honorable Aldermen: O'Neil, Arnold, Long, Corriveau, and Shaw

Dear Honorable Committee Members:

The most recent presented audit schedule proposed an audit of certain programs of the Parks and Recreation and Cemeteries Division. The first audit, an audit of the Derryfield Country Club Golf Operations was completed in April. The audit being presented today is an audit of the Derryfield Country Club restaurant management agreement.

Audit Scope:

This audit is a contract compliance audit of the contract between the City of Manchester and BLL Restaurant, Inc. The contract is a management agreement to operate the restaurant at the Derryfield Country Club.

The audit procedures began with an analysis of the restaurant agreement and selection of 17 items that were determined to be significant for detail testing. In addition an understanding of the internal control system in place to ensure that the contract requirements were being met as intended was documented and tested.

Conclusion:

Of the 17 contract provisions tested I noted three minor instances where the contract is not being complied with. These instances were found to have an immaterial effect on the overall administration of the contract.

- The restaurant is not being charged its share of casualty insurance
- Financial statements and payments for the City's share of revenue are not being processed timely and no penalty for late filing is being assessed
- The restaurant is not providing annual preventative maintenance reports

In my opinion, except for the matters noted above the restaurant management and management at the Division of Parks, Recreation and Cemeteries was found to be in compliance with the restaurant agreement.

The draft audit report was sent to the management of the Parks and Recreation Division for their review and comment. The observations generated and the auditee written responses are included in the report that follows. The auditee responses indicate general agreement with the report's recommendations and state that corrective action will be taken. We appreciate the courtesy and cooperation of the staff and administration of the Parks and Recreation Division on this assignment.

Respectfully Submitted,

Kevin Buckley, CPA
Internal Audit Manager

INTRODUCTION

AUDIT BACKGROUND

According to the proposed audit schedule presented to the COA an attestation engagement of contract compliance with the management agreement between the City of Manchester and BLL Restaurant, Inc was selected for audit. The Office of the Independent City Auditor of the City of Manchester has been designated by City Charter with the authority to conduct such examinations and audits.

My audit was conducted in accordance with standards applicable to financial and compliance audits contained in Generally Accepted Government Auditing Standards (GAGAS), issued by the Comptroller General of the United States.

AUDIT SCOPE AND OBJECTIVES

The report is a contract compliance report which falls under the attestation engagement standards of GAGAS. The audit was an examination to obtain sufficient appropriate evidence to express an opinion on whether the management agreement between the City of Manchester and BLL Restaurant Inc. was being complied with in all material respects as of December 31, 2011 and the preceding three years.

Management at the Division of Parks, Recreation and Cemeteries is responsible for establishing and maintaining a system of management controls to ensure compliance with laws, regulations and requirements applicable to the management agreement between the City of Manchester and BLL Restaurant Inc. In planning and performing this audit consideration was made of the controls over contract administration that could have a direct and material effect over administration of the management agreement in order to determine the auditing procedures required to express an opinion on compliance with contract requirements of the management agreement but not for the purpose of expressing an opinion on the effectiveness of the controls over compliance. Accordingly no opinion is expressed over the effectiveness of controls over contract compliance.

Consideration of controls over contract compliance was for the limited purpose noted above and not to identify all deficiencies in internal controls over contract compliance. The audit did not identify any material weaknesses over such controls.

The results of our testing are included in the recommendation and observation section of this report found on pages four through eight.

BACKGROUND OF AUDITEES

On December 13, 2002 the City of Manchester entered into a management agreement with BLL Restaurant, Inc. (the Manager).

This agreement was an extension of a lease with the City dated December 15, 1994. The 1994 lease was to operate the Derryfield Country Club Restaurant in a portion of the building that also housed the golf operation and the Parks, Recreation and Cemeteries offices. The building was very old and required high maintenance costs. As part of the Parks and Recreation’s capital improvement program it was determined the building would be replaced with a new facility.

The 2002 agreement called for management of the new restaurant facility consisting of approximately 10,000 square feet on the first floor with an additional 3,400 square foot deck. The final agreement, after construction was completed, was changed to 9,500 square feet on the first floor, a 3,800 square foot deck plus 1,500 square feet of storage area in the basement level. The agreement is for a term of 25 years.

The Derryfield restaurant sits adjacent to the City owned Derryfield golf course and has a lounge and dining area which includes a deck area plus a banquet facility able to accommodate 200 to 300 guests. Live entertainment is scheduled most weekends.

REVENUE

For the year ended December 31, 2010 the facility had total gross revenues of \$2,929,566 consisting of:

Bar and Dining Room Sales	\$ 2,416,662
Function Room Sales	475,706
Golf Cart Sales	20,492
Cover Charges	16,706
TOTAL GROSS SALES	\$ 2,929,566

Per the agreement revenue is shared with the City based on 74.25% of debt service. The percentage is roughly the percent of the building that is occupied by the restaurant. This amount is fixed for ten years then shall increase by the lesser of the increase in CPI or 5% for the remainder of the agreement. This amount is paid monthly and is known as the minimum share of revenue. The minimum share of revenue is \$ 10,589.42 per month and is due on the first of the month.

In addition the manager pays the City a percent of gross revenue over a certain amount. This amount is calculated at the end of the year and is due 120 days after the end of the calendar year. Currently the percent of gross revenue is calculated as follows:

- 0.0% of revenue equal to or less than \$1,000,000
- 1.5% of revenue greater than \$1,000,000 but less than \$1,600,000
- 2.0% of revenue equal to or in excess of \$1,600,000

Revenue participation payments for the last four years were as follows:

Fiscal Year	Debt Service	Percent of Gross
2008	\$ 127,073.04	\$ 34,494.00
2009	127,073.04	34,565.00
2010	127,073.04	33,088.20
2011	127,073.04	35,591.00

The agreement also allows the City the ability to charge a late fee for any revenue not paid within ten days of the due date equal to 5% of the amount due plus interest on any amount due past 20 days at a 12% per annum rate.

OBSERVATION 1: LATE FINANCIAL STATEMENT FILINGS

Observation:

Section 5.b. of the restaurant agreement states that within 120 days of the end of each calendar year Manager shall provide Owner with financial statements and property management reports with respect to the prior calendar year and a calculation of gross revenues, share of revenues and its three component units.

In the addendum to the agreement, section c requires that the Owner shall annually forward copies of the Manager’s financial reports to the City’s internal auditor for review.

Section 4.a. of the management agreement requires that the percentage share of revenue shall be paid by Manager to Owner within 90 days after the end of the fiscal year. In addition section 13. of the management agreement states that if Manager fails to pay any amounts due to the owner under this agreement, including but not limited to the share of revenue, within ten days of the due date, Manager shall pay a late penalty equal to 5% of any overdue amount.

Testing has revealed that the submitted financial statements do not contain the required property management report and have been continually submitted past the required April 30th due date. This appears to be due to the audit not being completed timely by the public accountant. For example the audit report for calendar year 2010 was dated May 4, 2011. This causes the payment of the share of revenue to be continually late. The calendar year (CY) 2008 payment was submitted May 12 and June 18 of 2009, and CY 2010 submitted May 16 and June 1 of 2011. In neither of these instances was the 5% late penalty charged.

The Parks and Recreation Division have not been submitting the financial reports to the City auditor as required by the agreement.

Recommendation:

It is recommended that the management of the restaurant work with its auditors to ensure that the financial statements are audited and submitted in time for the timely submission of the City's share of revenues.

The Parks and Recreation management should ensure that the financial statements are complete, timely and accurate and that revenue is deposited timely to the City accounts. Financial statements should be submitted to the City Auditor annually and late payments where appropriate are levied and collected.

Auditee Response:

At a recent meeting the restaurant manager expressed doubt that his financial statements could be completed in accordance with the above schedule. However, since the schedule is formalized in the executed agreement, he will need to comply with the schedule or take steps to amend the agreement. The Parks Division does not have the authority to grant waivers from provisions of the agreement.

The Parks Division has been receiving and reviewing the financial reports annually, and will submit a copy of them to the City auditor beginning in 2012.

The amount of revenue collected consists of a third component. The agreement calls for the manager to pay the City its pro rata share, based on square footage occupied, of the cost of the owner for self insuring the building against casualty loss. The insurance amount shall be paid within 30 days of the City invoicing the manager.

OBSERVATION 2: CASUALTY INSURANCE SHARE NOT BEING CHARGED

Observation:

Exhibit B. 1. of the management agreement states that “Beginning on the commencement Date and thereafter when invoiced, Manager shall pay Owner its pro-rata share (as a function of square footage), as reasonably determined by Owner, of the cost to the Owner of self-insuring the Building against casualty loss”.

The restaurant occupies approximately 66% of the entire building. Based on billings sent to the Parks and Recreation Division from the City Risk manager the following amounts should have been invoiced by the owner:

Fiscal Year Billed	FY 2010	FY 2011	FY 2012	Total
Derryfield Insurance	\$ 2,809	\$ 2,809	\$ 2,900	\$ 8,518
Restaurants Share (66%)	\$ 1,854	\$ 1,854	\$ 1,914	\$ 5,622

It does not appear that the City charges the restaurant its share of casualty insurance as allowed by the management agreement thereby resulting in lost revenue for the past two fiscal years plus the current year of \$6,303. It does not appear the restaurant has ever been invoice for its share of casualty insurance.

Recommendation:

The City should be invoicing the restaurant its pro-rata share of casualty insurance as noted in the agreement.

Auditee Response:

The restaurant manager was told recently that he would be invoiced for 66% of the Casualty Insurance as per the agreement beginning in June of 2012. The 2012 invoice will include FY2010 through FY2012 as shown above.

REPORTING

The agreement requires a number of reports to be submitted to the City in order to show compliance with financial and operating requirements. Annually management is required to provide:

- A complete set of financial statements
- Property Management Report
- Preventative Maintenance Inspection Report

These reports are used to provide the City with evidence that revenues are calculated correctly and that the management of the restaurant is adequately maintaining the building. My testing has revealed the following issue with the reporting requirements.

OBSERVATION 3: ANNUAL PREVENTATIVE MAINTENANCE REPORTS

Observation:

Section 11.f. of the management agreement calls for annual preventative maintenance on all mechanical systems with a report of the maintenance to be provided to the owner annually.

It does not appear that the management submits preventative maintenance reports as required by the agreement.

Recommendation:

The annual preventative maintenance reports should be submitted annually as part of the financial report package submitted to the owner.

Auditee Response:

In a meeting with the restaurant manager he agreed to submit annual preventative maintenance reports beginning in June 2012. Although we haven't received annual reports we are aware of the work done on the building by both the manager and the city facilities division. We are confident that appropriate tasks are complete and will formalize this with the reporting.

Appendix

Restaurant Management Agreement