

**CITY OF BUFFALO
DEPARTMENT OF AUDIT AND CONTROL**

**AUDIT REPORT
CONTRACT FOR OPERATION OF ERIE BASIN
MARINA FOR THE YEARS 2008 - 2012**

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Preface

The City of Buffalo (the “City”) constructed the Erie Basin Marina located at 329 Erie Street on Buffalo’s waterfront in 1974. The Marina consists of a boat harbor, marina and multi-purpose recreational and food service facility for use by the general public. After a Request-for-Proposal in 2001 the City entered into a lease agreement with Brand-On Services, Inc. (the “Operator”) to operate the Marina.

Summary of Lease Agreement

The lease agreement (the “Contract”) between The City of Buffalo and Brand-On Services, Inc. requires rental payments from the Operator to the City based on sales at Erie Basin Marina (the “Marina”). The Rental Amount is calculated by the Operator and is submitted to the City annually. The Rental Calculation is based on three categories of sales:

1. **Base Sales** – defined as sale of food, beverages, sundry items, transient slip rental and sewage pump out. The Operator is to pay rent between 7 – 13% of sales, escalating as Base Sales increase.
2. **Fuel Sales** – The Operator shall pay the City 10% of all fuel sales, net of taxes.
3. **Gross Marina Revenue** – The Operator is to pay the City between 40 – 55% of revenue from slip rental, dry storage of boats, daily and seasonal boat launch fees, Miss Buffalo and Moondance dock rental fees. Additionally the lease allows for installation of floating docks at the Operator’s expense. The City is to receive 5% of the gross rentals from these docks in the 4th through 10th seasons after installation.

Rent due related to Base Sales plus Fuel Sales is subject to a minimum rent payment of \$80,000. Rent due related to Gross Marina Revenue is subject to a minimum rent payment of \$115,000. An annual deduction from rent of \$87,000 is allowed as the Operator has assumed the responsibility of maintaining the entire Marina including the lawn and garden areas. This reduction in rent was approved by the Common Council on March 30, 2004 (Item No. 70 CCP Mar 30, 2004). The Contract requires approval from the Common Council for any reduction in rent. The minimum annual rent due to the City for the Marina is \$108,000 (\$80,000 + \$115,000 - \$87,000).

The Contract term runs through the 2013 season with a two year renewal option that can be exercised upon mutual agreement of both parties extending the term through 2015.

Audit Objectives

The audit objective is to verify the proper amount of rent was paid to the City for the 2008 – 2012 seasons in accordance with the terms of the Contract. In order to accomplish this, the following procedures were performed:

- Verify mathematical accuracy of the Rental Calculation.
- Verify proper amounts recorded as Base Sales on Rental Calculation by vouching amounts to supporting documentation, including daily sales summaries and cash register receipts listing food, beverage and sundry sales.
- Verify proper amounts recorded as Fuel Sales by vouching gallons of fuel sold on Rental Calculation to letter received from fuel distributor confirming gallons of fuel delivered.
- Verify proper amount recorded as Gross Marina Revenue on Rental Calculation by vouching amounts to supporting documentation, including slip rental schedules, slip rental contracts and boat launch tickets.
- Verify payments on Rental Calculation agree to amounts received by the City.

Summary of Audit Results

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>Total</u>
Rent Payable Per Operator	\$ 233,022	\$ 219,340	\$ 222,847	\$ 231,249	\$ 249,454	\$1,155,912
Rent Payable Per Audit	<u>262,908</u>	<u>234,556</u>	<u>239,228</u>	<u>267,402</u>	<u>270,686</u>	<u>1,274,780</u>
Errors in Calculation of Rent	29,886	15,216	16,381	36,153	21,232	118,868
Credits against Rent per Operator	(233,022)	(104,148)	(110,791)	(114,334)	(120,997)	(683,292)
Credits against Rent per Audit	<u>(102,880)</u>	<u>(87,299)</u>	<u>(89,102)</u>	<u>(89,688)</u>	<u>(89,946)</u>	<u>(458,915)</u>
Excess Credits Deducted from Rent	<u>130,142</u>	<u>16,849</u>	<u>21,689</u>	<u>24,646</u>	<u>31,051</u>	<u>224,377</u>
Amount Due to City per Audit	<u>\$ 160,028</u>	<u>\$ 32,065</u>	<u>\$ 38,070</u>	<u>\$ 60,799</u>	<u>\$ 52,283</u>	<u>\$ 343,245</u>

Several errors were discovered in the Rental Calculation provided by the Operator resulting in an underpayment of rent of \$343,245 for the five years under audit. The three most significant errors were related to calculation of rent due on Base Sales, Fuel Sales and amounts deducted from rent not allowed under the terms of the Contract. First, rent due related to Base Sales was calculated by the Operator using a rate lower than agreed to in the Contract and certain sales were omitted from the calculation. Second, rent due on Fuel Sales was calculated by the Operator at a rate of \$0.10 per gallon as opposed to the contractual rate of 10% of sales and certain sales were not included in the calculation. Third, amounts were subtracted from rent for maintenance costs incurred by the Operator. The Contract does not

allow for deductions in rent without approval from the Common Council. No proof of approval by Common Council was provided to justify the deductions from rent.

Other errors of lesser cost to the City were found related to the reporting of slip rental fees, boat launches and other credits deducted from rent. Insufficient documentation was provided by the Operator to verify amounts recorded on the Rental Calculation as transient slip rental.

Audit Findings

1. Errors in Reporting of Base Sales in Rental Calculation

In accordance with the contract, Base Sales are defined as gross sales of food and beverages, along with sundry items from the ship store. Base Sales also include sales from vending, food carts, additional food or ice cream stands, transient slip rentals and sewage pump out. The Operator provided a daily sales summary of these items and the corresponding cash register tapes verifying the sales. The cash register tapes were compared to the daily sales summary to verify the accuracy of the daily sales summary. Then the daily sales summary sheets were totaled and compared to the Rental Calculation. The totals from the daily sales summaries did not agree to amounts recorded on the Rental Calculation resulting in Base Sales being understated on the Rental Calculation by \$107,407. The differences were not adequately explained by the Operator. The Operator stated \$48,064 of 2008 and \$8,785 of 2009 unreported Base Sales were attributable to “Cash over/short.” Further explanation was not provided.

Transient slip rentals of \$56,796 were not included in Base Sales as specified in the Contract, these sales were erroneously included in Gross Marina Revenue in the Rental Calculation. This error resulted in an overpayment of rent to the City and was adjusted in the Auditor Rental Calculation, see Appendix A for further detail.

Rent due on Base Sales was not calculated using the proper rates. The Contract requires payment of rent on Base Sales at rates varying between 7 – 13 % depending on volume of Base Sales. The Operator was calculating rent due at rates between 7 - 10%. In a letter from the Operator’s Accountant this error was acknowledged and it was agreed that amounts related to this miscalculation would be repaid at the conclusion of the 2013 season. The repayment amount proposed by the Operator is \$24,510.

The amount of Rent on Base Sales understated by the Operator is as follows:

	2008	2009	2010	2011	2012	5 Year Total
Understated Rent on Base Sales	\$8,315	\$6,180	\$4,801	\$12,097	\$12,648	\$44,041

For the period under audit rent due related to Base Sales was understated by \$44,042 and Base Sales of \$164,204 were unreported by the Operator.

2. Errors in Reporting of Fuel Sales in Rental Calculation

The Contract states “The Operator shall pay the City 10% of all fuel sales, net of taxes.” The Operator’s Rental Calculation uses a rate of \$0.10 per gallon on fuel sales to calculate rent due on fuel sales. On March 7, 2006 a letter was written by the Operator to then Commissioner of Public Works Joseph Giambra. The letter states a conversation took place between the two parties and it was agreed to change from the 10% rate stated in the Contract to the rate used in the Rental Calculation of \$0.10 per gallon. No further documentation of this conversation was provided. The Contract states that only the Common Council can approve matters involving reductions in rent, therefore the change in the calculation is not valid.

The fuel supplier provided a letter confirming the number of gallons of fuel supplied to the Operator. This was obtained to verify an accurate number of gallons of fuel sold were reported in the Rental Calculation. The number of gallons sold in the Rental Calculation was 20,689 gallons lower than the number of gallons delivered by the fuel supplier for the period under audit.

As a result of the unauthorized change in the calculation of rent due on Fuel Sales and unreported fuel sales, rent due on fuel sales was understated as follows:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>5 Year Total</u>
Understated Rent on Fuel Sales	\$23,251	\$11,779	\$10,710	\$17,165	\$20,018	\$82,923

3. Errors in Reporting of Gross Marina Revenue in Rental Calculation

The Gross Marina Revenue is composed of rental of boat slips, boat launches at the boat ramp, dry dock storage of boats and dock rental to the Miss Buffalo and Moondance. Rent of 40 – 55% of gross revenue is due based on these sales. Also included in Gross Marina Revenue are amounts from Floating Docks purchased and installed by the Operator. The rent due on these docks is at a rate of 5% of gross rentals for the 4th through 10th seasons after installation. The docks were installed prior to the 2005 and 2007 seasons therefore rent is due beginning with the 2008 and 2010 seasons, respectively.

Several errors were noted in reviewing the Rental Calculation related to Gross Marina Revenue, including minor understatement of amounts for boat slip rental and boat launching fees. Also improperly included in Gross Marina Revenue were Transient Slip Rentals. In accordance with the contract Transient Slip Rentals are to be recorded as Base Sales. All

amounts were adjusted in the Auditor’s Rental Calculation in Appendix A. After the adjustments Rent on Gross Marina Revenue was overpaid by the operator as follows:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>5 Year Total</u>
(Over)understated Rent on Gross Marina Revenue	\$ (1,680)	\$ (2,743)	\$ 870	\$ 6,891	\$(11,434)	\$ (8,096)

The Operator recorded \$6,793 more in rent than was due related to Gross Marina Revenue.

4. Unauthorized Deductions from Rent

In accordance with the Contract deductions from rent must be approved by the Common Council. The Operator received approval from the Common Council for a credit of \$87,000 for performance of maintenance services at the Marina (Item No. 70 CCP Mar 30, 2004). In the Rental Calculation under the title “City Maintenance Charges” amounts have been deducted from the rent due in addition to the \$87,000 credit approved. No documentation was provided demonstrating Common Council authorization of these additional maintenance credits. Thus the deductions are not allowable in accordance with the Contract.

Additionally, miscellaneous credits for security, construction of a patio and dock bumper turning (required maintenance related to docks needed to be performed each spring and fall) were deducted from rent. No approval from Common Council for these miscellaneous deductions was provided by Operator, therefore the amounts are not allowable deductions from rent.

Unauthorized deductions from rent are as follows:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>5 Year Total</u>
Unauthorized Maintenance Credits	\$110,216	\$15,224	\$21,689	\$20,556	\$28,551	\$196,236
Unauthorized Miscellaneous Credits	19,926	1,625	-	4,090	2,500	28,141
Total Unauthorized Credits deducted from Rent	<u>\$130,142</u>	<u>\$16,849</u>	<u>\$21,689</u>	<u>\$24,646</u>	<u>\$31,051</u>	<u>\$ 224,377</u>

The Operator stated in a letter dated July 12, 2013 “we were instructed by Commissioner of Public Works Joseph Giambra and the City of Buffalo Harbor Master to perform city maintenance items which should be deducted from the rent.” It should be noted Mr. Giambra has not been Commissioner since December 2006. No documentation of these instructions were provided. Additionally no record of necessary approval from the Common Council on

matters involving reductions in rent was provided. Therefore these are unauthorized deductions from rent and the amount of \$224,377 is immediately payable to the City.

5. Other Findings

The contract was awarded to Brand-On Services, Inc. The spouse of the Company President was an employee of the City when the contract was executed. The employee worked in the Department of Public Works, the department that awarded the Contract. The employee retired from the City in 2012. Also, the son of the President is a current employee of the City of Buffalo in the Department of Public Works. These factors suggest a conflict of interest may have existed at the time of execution of the contract and may still exist.

There was inadequate support provided to document revenue related to Transient Boat Slip Rental. No further audit procedures were performed on amounts recorded as Transient Boat Slip Rental as it was determined the resources needed to perform further testing would exceed the expected results of the testing.

Audit Recommendations

1. Request for Immediate Payment of Amount Due

An Invoice should be sent immediately by the Department of Public Works to the Operator for the total amount due to the City of \$343,245. If the amount due cannot be paid immediately further action should be taken by Corporation Counsel to ensure collection of this debt.

2. Termination of Contract at end of Season

In accordance with the terms of the Contract the Common Council must approve any matters involving a deduction in rent. This procedure was followed to receive an \$87,000 credit for performing additional maintenance at the marina, but was not followed to reduce the amount paid to the City for fuel sales or for taking additional credits against rent. The terms of the Contract have been violated at the expense of the taxpayer. If immediate corrective action is not taken, including payment of amounts due to the City, the Common Council should not approve the additional two year extension of the lease.

3. Strategic Review of Marina Use and Operation

A strategic review of the Marina should be conducted to determine how to maximize both economic return on Marina assets and enjoyment to the taxpayers. It should be determined if the Marina is best operated by one vendor or if restaurant and marine services would be best handled by separate vendors. Also it should be determined if public ownership of the entire Marina is in the best interest of the taxpayer or if selling the restaurant to a private entity could create a better return on assets to the taxpayer.

