

OFFICE OF THE CITY CONTROLLER



PARKS AND RECREATION DEPARTMENT (PARD)

CONTRACT COMPLIANCE AUDIT

**CONTRACT NO. C29115 – HERMANN PARK GOLF COURSE
CONCESSION CONTRACT WITH BSL GOLF CORPORATION
(BSL)**

Ronald C. Green, City Controller

David A. Schroeder, City Auditor



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

RONALD C. GREEN

September 14, 2011

The Honorable Annise D. Parker, Mayor
City Council Members
City of Houston, Texas

**SUBJECT: REPORT NO. 2012-03 PARKS AND RECREATION DEPARTMENT (PAR), COMPLIANCE
AUDIT OF CONTRACT NO. C29115 – HERMANN PARK GOLF COURSE CONCESSION
CONTRACT WITH BSL GOLF CORPORATION (BSL)**

Mayor Parker:

The Controller's Office has completed a Compliance Audit of Concession Contract No. C29115 (Agreement) between City of Houston (City) and BSL. The Agreement provides PARD with management services of the golf course activities for Hermann Park Golf Course. One element of the Agreement is to make concession payments to PARD based on a percentage of gross sales earned by BSL for revenue generating activities. Therefore, the objectives of this audit were to:

- Identify, document and determine whether internal controls over revenue are working effectively to provide reasonable assurance that revenue is received, recorded, and reported to PARD for purposes of concession payments; and
- Determine if the Concessionaire is in compliance with relevant contract terms.

It was noted during the audit that the golf course was in good operating condition, offered quality products, and had sound internal controls over the sales process. *However*, concession payments contingent upon favorable interest rates for financing the contractually required improvements were not in compliance with the terms of the Agreement.

The significant issues identified that were related to the audit objectives, noted that:

- In July 2009, BSL refinanced the loan for Hermann Park capital improvements to a lower rate, which triggered a liability to the City related to the realized savings. The additional concessionaire payment had not been scheduled or submitted for the interest rate differential as required by the Agreement. As of August 2011, the accrued concession payment owed to the City is calculated to be **\$108,755**; and
- Audited financial statements are not submitted to PARD.

Management from both BSL and PARD provided responses and/or comments to each of the issues and, as such, are embedded within the report verbatim. Additionally, sections of specific responses are embedded in the report within the related finding.¹

We appreciate the overall cooperation we received from PARD and BSL throughout the project and we note that PARD is in agreement with the findings and has committed to recover the amounts identified in the attached report.

Respectfully submitted,

Ronald C. Green
City Controller
Houston, Texas

¹ Under Generally Accepted Government Auditing Standards, 8.33 states "Auditors should include in their report a copy of the written comments, or a summary of the comments received"; 8.34 states "Auditors should also include in the report an evaluation of the comments as appropriate."



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EXECUTIVE SUMMARY

BACKGROUND

The Audit Division of the Office of the City Controller has completed an audit of the contract between the City of Houston and BSL Golf Corporation (BSL). BSL is a private management company that has managed the City's Hermann Park Golf Course since March 8, 1989. PARD's Recreation and Wellness Division is responsible for managing the contract terms with BSL.

The audit was part of a series of performance/contract compliance reviews of City golf courses, which consisted of (1) City-Operated (Performance Audit of Memorial and Brock Parks) and (2) privately managed (Contract Compliance Audit of Hermann and Glenbrook Parks). Report 2011-05, *Performance Audit of City-Operated Golf Courses* documented the results of the audit of golf courses managed by the City. This report provides the results of the audit of Hermann Park Golf Course managed and operated by BSL. A separate report will be issued for Glenbrook Park following the release of the this report.

Hermann Golf Course is an 18-hole course that is conveniently located for visitors to the Texas Medical Center, historic Museum District, Houston Zoo, and the Rose Gardens. In 1999 the entire course was renovated, which included the addition of a new Clubhouse. In 2010 the Houston Chronicle ranked it fourth in *Course with Best Value*.

The original contract (#C29115) has been amended four times, with the most recent amendment being executed on April 12, 2006. The Agreement's termination date is March 8, 2014.

The third amendment to the Agreement was to accommodate the renovation of the course. The amendment required BSL to expend no less than \$3.65 million on capital improvements to the course. The cost to renovate the golf course according to the agreement was reported by BSL as \$5.3 million (direct cost of \$4.2 million and overhead of \$1.02 million). Initially, construction was to begin in November 1997 and be completed by July 1998, but due to various delays the improvements were not completed until December 1999.

The original Agreement required BSL to submit annual guaranteed minimum concession payments of \$250,000. In consideration for BSL financing the capital improvements to the course, the concession payments were adjusted in the third amendment. The annual guaranteed payment of \$250,000 was replaced with a tiered system that increases every four to five years. Based on the current tier, **Table 1** shows the annual concession payments and rounds of golf played that were reported to PARD for the last five (5) years.¹

¹ The current tier covers the period of January 1, 2009, through the end of the contract and requires BSL to make annual concession payments of seven percent (7%) on gross receipts for green fees, cart fees and driving range revenues and three and a half percent (3.5%) of gross receipts for all other revenues, including but not limited to food and beverage sales and merchandise sales.



Table 1		
Hermann Park Golf Course		
5-Year Annual Concession Payments and Rounds of Golf Played		
Fiscal Year	Payments	Rounds of Golf
2007	\$ 90,750	41,336
2008	\$ 101,269	47,969
2009	\$ 110,216	46,319
2010	\$ 119,791	46,029
2011	\$ 114,194	49,835
Totals	\$ 536,220	231,488
5-Year Average	\$107,244	46,298

AUDIT SCOPE

The audit focused on revenue at Hermann Park Golf Course, and some of the contract stipulations and requirements for performance by BSL. The scope period for the audit included the entire contract term since origination in 1989, along with specific analysis of some transactions that occurred between January 1, 2010 and October 31, 2010.


The scope of our work did not constitute an evaluation of the overall internal control structure of either PARD or BSL. PARD and BSL management is responsible for establishing and maintaining a system of internal controls to ensure assets are safeguarded, financial activity is accurately reported and reliable, and management and their employees are in compliance with laws, regulations, and agreements with other entities. The objectives are to provide management with reasonable, but not absolute, assurance that the controls are in place and effective.

AUDIT OBJECTIVES

The initial Audit Notification letter was distributed to the Mayor, the Department Director, and City Council Members, while an additional communication was then sent from the Director of PARD to BSL notifying them of the audit. The initial audit objectives were broadly defined and meant as a starting point for the engagement.

After consideration of risk and preliminary review of internal controls the audit objectives were refined to:

1. Identify, document, and determine whether internal controls over revenue are working effectively to provide reasonable assurance that revenue is received, recorded, and reported to PARD for purposes of concession payments.
2. Determine if the Concessionaire is in compliance with relevant contract terms.



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PROCEDURES PERFORMED

Some of the key audit procedures performed to meet the audit objectives and provide a basis for our conclusions were as follows:

- Obtained and reviewed contract #C29115 and the four amendments between PARD and BSL;
- Performed interviews with golf management to gain an understanding of the relevant control environment;
- Analyzed detail transactional data from the Point-of-Sale (POS) system; and
- Verified BSL was in compliance with the Agreement concerning: insurance, licenses and permits, health inspections, facility maintenance, and capital improvement loan refinancing.

AUDIT METHODOLOGY

We conducted this audit in accordance with generally accepted government auditing standards (Yellowbook) issued by the Government Accountability Office (GAO) and those promulgated by the Institute of Internal Auditors (Redbook). Those standards require that we plan, perform, supervise, and review the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives.

SUMMARY CONCLUSIONS AND SIGNIFICANT ISSUES

CONCLUSION 1 –

Based on our review of the Agreement, we determined that while BSL was generally compliant with some of the terms of the contract tested, they were not in compliance with some key stipulations. **(Audit Objective #2 and Findings #1 and #2)**

- In July 2009, BSL refinanced the loan for Hermann Park capital improvements to a lower rate, which triggered a liability to the City related to the realized savings. The additional concessionaire payment had not been scheduled or submitted for the interest rate differential as required by the Agreement. As of August 2011, the accrued concession payment owed to the City is calculated to be **\$108,755 (Finding #1)**; and
- Audited financial statements are not submitted to PARD. **(Finding #2)**

CONCLUSION 2 –

Based on our review of revenue, internal controls are in place and working effectively to ensure revenue is received and recorded at Hermann Park Golf Course. **(Audit Objective #1)**

ACKNOWLEDGEMENT

The Audit Team would like to thank PARD and BSL for their efforts throughout the course of the engagement.



Camille E. Jones
Lead Auditor



David A. Schroeder
City Auditor



DETAILED FINDINGS, RECOMMENDATIONS, MANAGEMENT RESPONSES², AND ASSESSMENT OF RESPONSES

1. CONTRACT COMPLIANCE – CONCESSION PAYMENTS FOR FAVORABLE FINANCING RATES

BACKGROUND:

On December 2, 1997, BSL and the City agreed to a third amendment of the original Contract with PARD in regards to capital improvements at Hermann Park Golf Course. The improvements included, but were not limited to construction of a new clubhouse and cart storage facility, irrigation system, renovations to the old clubhouse, and parking lot. In consideration of PARD's agreeing to extend the concession term and accept lower guaranteed minimum annual concession payments, BSL agreed to spend **no less** than \$3.65 million on the improvements.

Article II, Financing, of the amendment states "...If at any time during the term of this Agreement or any extension thereto, the Concessionaire is able to finance or re-finance Project costs at less than 10 percent, the Concessionaire shall pay all savings realized therefrom to the City as concession payments, in accordance with a payment schedule to be determined by the Concessionaire and Director. Such payment(s) shall be in addition to any guaranteed minimum annual concession payments due under the terms of the Original Contract or this Agreement."

Article IV, Concession Payments of the amendment, eliminated the minimum guaranteed annual payment of \$250,000 and reduced the percentage of Revenue Receipts which were eighteen and one-half percent (18 ½%) for golf fees and cart rentals and five percent (5%) for all other revenues. It was replaced with a tiered fee schedule that began with five and one-half percent (5½%) and two percent (2%) respectively. The rates are scheduled to increase every four or five years through 2019.

Article V, Concession Term extended the Contract to March 8, 2014 and deleted all references to renewal terms.

\$1.8 million of the initial \$4.1 million loan to finance the required improvements was refinanced on July 27, 2009 at six and one-half percent (6 ½%) for five years. According to the promissory note representing the re-finance, interest was calculated based on the "Prime Rate" plus 1 percent per annum, but it shall never be less than 6½ percent nor more than 8 percent. The "Prime Rate" has remained at approximately 3¼ percent since 2009.

² All responses were obtained directly from both BSL Management and PARD Management and have been embedded within this report exactly as submitted in their entirety

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FINDING:

- As of the date of the report, concession payments associated with the interest rate differential per the contract have not been recognized, paid, nor scheduled. To date, the accrued concession payment owed to the City is calculated to be \$108,755³.

Table 2			
Calculation of Accrued Concession Payment Owed			
Principal Balance of Re-finance	10% Interest from 7/2009 – 8/2011	6.5% Interest, from 7/2009 – 8/2011	Accrued Concession Payment owed as of 8/2011
\$1,800,000	\$303,122	194,367	\$108,755

NOTE: (1) Assuming the prime rate doesn't rise above 5.5% through the remainder of the note, the total concession payment owed to the City would be \$181,537. (2) At minimum, the interest rate differential for the term of the current loan would be approximately \$152,000. This uses the assumption of an immediate increase in the prime rate to 7%, and the loan being held to term. Subsequent re-financing could occur, which could also have an impact.

- The Contract extension date noted in *Article V* (March 8, 2014) is in conflict with the percentage of Revenue Receipts final dates *Article IV* (March 9, 2014 through March 8, 2019).

Generally, City contracts state an end date with the possibility for one to three automatic extensions for a period of years. In the case of this contract, it specifically states that any reference to a renewal is deleted. However, in the preceding Article IV, it requires BSL to make percentage of Revenue Receipt payments past the end date of the contract.

RECOMMENDATION:

BSL should pay the City the accrued concession payment for the interest rate differential of \$108,755. Additional monthly concession payments going forward should include the interest differential per Article II of Amendment III. A payment schedule should be determined per the Contract for any/all elements described.

BSL and PARD, with the assistance of the City Legal Department, should properly align the final date associated with Revenue Receipts to be consistent with the stated contract end date.

³ Accrued Concession payment was calculated based on amortization tables using an annual rate of 10% vs. 6.5% respectively. The result was the accumulated difference between the two interest payments beginning from the inception of the re-finance, July 2009 through August 2011. NOTE: In our calculation, we did not apply additional interest to the accrued concession payment.



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BSL

RESPONSE:

- *“The 2009 loan was reviewed by the City of Houston attorney, PARD, the lender’s attorney and BSL’s attorney and the discrepancy was not noticed or brought to our attention. If made aware, BSL would not have put up \$1,700,000 in collateral to reduce the interest rate.*
- *BSL is willing to meet with Director of PARD and arrange an agreed upon payment schedule and solve all other contract issues.*
- *BSL feels the new loan in 2009 was for money spent over and above the contracted amount of \$3,650,000 and that BSL should not be penalized for spending more and giving a better product. The final capital expenditures totaled \$5,358,717.*

BSL Golf has always contended that the actual expiration date of the concession agreement is 2019 and that a five year extension was omitted by scrivener’s error from the original concession agreement. The concession agreement had established concession payments to the City through 2019. Generally, most City concession agreements and all prior agreements with the city included automatic extensions.”

PARD

COMMENT:

“THE DEPARTMENT APPRECIATES THE AUDITORS’ BRINGING THIS SITUATION TO OUR ATTENTION. WE WILL BE WORKING DIRECTLY WITH BSL TO ESTABLISH A PAYMENT SCHEDULE OF PAST AND FUTURE PAYMENTS DUE TO THE DEPARTMENT.

THE DEPARTMENT IS UNDER THE IMPRESSION THAT THE AGREEMENT ENDS IN 2014 WITH NO EXTENSION PER THE LETTER DATED JULY 27, 2009. WE WILL WORK WITH THE CITY LEGAL DEPARTMENT TO ESTABLISH THE CORRECT EXPIRATION DATE PER THE AGREEMENT. WE WILL THEN MEET WITH BSL TO COMMUNICATE THE EXPIRATION DATE AND CONFIRM IN WRITING.”

**AUDIT DIVISION ASSESSMENT OF
BSL RESPONSES:**

- While the loan was reviewed by all parties as indicated in BSL’s response, this does not change the issue of non-compliance to contract terms.
- The required investment was stated as “no less than \$3.65 million”, not specifying a maximum. The \$5.3 million amount reportedly spent by BSL included an allocation of overhead costs of approximately \$1.0 million or 25% of the direct costs and 20% of the total costs. Overhead is not considered part of the required improvements. The total direct investment was reported as approximately \$4.2 million which is close to the amount of the original loan (\$4.1 million). The indirect costs were covered by the reduction in required payments per the third Amendment.

The Legal Department has reviewed the Agreement term date and stated that at the time of the third Amendment it was City Council’s (Council) intention that the Agreement end in 2014. Any extensions will have to go before Council for approval.



2. CONTRACT COMPLIANCE – REPORTING AND OPERATIONAL REQUIREMENTS

BACKGROUND:

PARD entered into an eight-year Agreement with BSL Golf Corporation (BSL) on March 8, 1989, for the operation of Hermann Park golf course. On December 2, 1997, an amendment extended the contract terms to March 8, 2014.

The Agreement and its four amendments have stipulations that BSL must comply with and the PARD is responsible for enforcing. Some of these requirements are as follows:

- Financial requirements, such as audited balance sheet and income statement must be submitted to PARD;
- Prices to be charged for golf services and rentals must be posted for the public to view;
- Minimum maintenance standards, such as repairs to cart paths, facility repairs, and golf grounds maintenance; and
- Maintain a minimum of 70 golf carts and 35 push carts for customer use.

FINDING:

The following are items where BSL was not in compliance:

- Audited financial statements are not submitted to PARD;
- Prices were not posted for the public to view;
- BSL did not have the 35 required hand carts; and
- Signs were not on vending machines noting where customers could obtain a refund.

RECOMMENDATION:

BSL should come into compliance with the Agreement by (at minimum):

- Having external audits of financial statements performed and submitted to PARD on an annual basis;
- Acquiring and maintaining the required number of hand carts, or obtaining a waiver from PARD; and
- Post prices clearly and identify where refunds can be obtained;

BSL

RESPONSE:

- *“Management will comply with the pull cart requirement if the City deems this necessary. However, BSL believes that this requirement is outdated since pull carts have not been requested on the site since the course has been redesigned. The ridership on the course is in excess of 90%. The City stands to make more money with automated carts being the only option.*
- *Prior year audits were done with all golf courses that BSL Golf owned or operated. Since more courses were included in this information BSL felt there was confidential information therein and therefore, did not supply. In the year 2010 BSL engaged Melton and Melton, LLP to review the agreed upon procedures for the Hermann Park Course contract and have provided a copy of their report to Ms. Cheryl Johnson along with the monthly concession payment for the month of May 2011.*
- *Prices have been posted according to contract.*
- *Signs for refund have been posted according to contract.”*



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PARD

COMMENTS:

“THE DEPARTMENT BELIEVES PUSH CARTS ARE STILL NEEDED AT THE COURSE, BUT CAN BE REDUCED FROM 35 TO 20. WE WILL MAKE THIS CHANGE IN WRITING AND SEND TO BSL FOR THEIR FILES.

THE DEPARTMENT HAS RECEIVED THE DOCUMENT MENTIONED ABOVE BY BSL ENTITLED “REPORT ON AGREED UPON PROCEDURES FOR THE YEAR ENDED DECEMBER 31, 2010”; HOWEVER THIS REPORT DOESN’T SATISFY THE CONTRACTUAL AGREEMENT WHICH STATES “THE CONCESSIONAIRE WILL FURNISH A COPY OF ITS AUDITED BALANCE SHEET AND A COMBINED PROFIT AND LOSS STATEMENT.” THESE STATEMENTS HAVE NOT BEEN RECEIVED BY PARD TO THIS DATE.”

AUDIT DIVISION ASSESSMENT OF

BSL RESPONSE:

Contract clauses that preserve audit rights are paramount to the accountability and integrity of the contractual relationship. The Agreement requires access to information sufficient to audit the vendor’s compliance with relevant terms. The Office of the City Controller’s Audit Division is cognizant of information that is sensitive, confidential, and/or of a nature that would diminish the competitive advantage of a vendor. Documents that were requested in order to adequately perform our audit procedures are considered “Audit Workpapers”. Section 552.116 of Title 5, Subtitle A, Chapter 552 of the State of Texas Statutes specifically excludes “Audit Workpapers” from public request. Additionally, the professional standards to which the Audit Division adheres requires us to comply with a Code of Ethics Statement that contains the principle of Confidentiality. This recognizes that in the course of our work, we have access to information that is sensitive and are to keep it confidential and not derive personal gain.