



Office of the City Auditor Stumpy Lake Golf Course Lease

Report Date: April 15, 2011



Office of the City Auditor

"Promoting Accountability and Integrity in City Operations"

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Lyndon Remias, CPA, CIA
Chris Ford, CPA

City Auditor
Deputy City Auditor

Office of the City Auditor
2401 Courthouse Drive, Room 344
Virginia Beach, VA 23456

Telephone: 757.385.5870

Fax: 757.385.5875

Fraud, Waste, and Abuse Hotline 757.468.3330



Office of the City Auditor
Transmittal Letter



Date: April 15, 2011
To: James K. Spore, City Manager
Subject: Review of Stumpy Lake Golf Course Lease

I am pleased to present the report of our review of the Stumpy Lake Golf Course Lease. The results of this review will be provided to City Council through the City's Audit Committee.

We have performed the agreed upon procedures related to compliance with the lease between the City of Virginia Beach and Stumpy Lake Golf Course Inc. This agreed-upon procedures engagement was conducted in accordance with Government Auditing Standards. Government Auditing Standards incorporate financial and attestation standards established by the American Institute of Certified Public Accountants. These standards also provide guidance for performing and reporting the results of agreed-upon procedures.

The Office of the City Auditor reports to City Council through the City's Audit Committee and is organizationally independent of all other City Departments. The procedures we agreed to perform and the associated results are enclosed. Findings considered to be of insignificant risk have been discussed with management. We completed the agreed-upon procedures on March 4, 2011.

This report is intended solely for the information and use of the Audit Committee, City Council, City Manager, the Department of Parks and Recreation and appropriate management. It is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

We would like to commend personnel from the Department of Parks and Recreation and Stumpy Lake Golf Course Inc. for the courtesy and cooperation extended to us during the review. If you have any questions about this report or any audit-related issue, I can be reached at 385-5872 or via email at lremias@vbgov.com.

Respectfully submitted,

Lyndon S. Remias, CPA, CIA
City Auditor

c: City Council Members
Audit Committee Members
Cindy Curtis, Interim Deputy City Manager
Mary Cole, Acting Director, Parks and Recreation



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Purpose

To verify compliance with the lease between the City of Virginia Beach (lessor) and Stumpy Lake Golf Course Inc. (lessee) dated January 1, 2008.

Scope and Objectives

The objectives of our review were:

1. To verify that the monthly lease payments from Stumpy Lake Golf Course Inc. to the City of Virginia Beach were made in compliance with the lease dated January 1, 2008 for the lease years 2008, 2009 and 2010. This also included verification that the payments were properly accounted for by the City of Virginia Beach.
2. To verify that the lessee made all of the required capital expenditures specified in the lease agreement.
3. To identify other significant lease provisions that required lessee performance and verify compliance with those provisions.

Our scope covered the first three lease years of 2008, 2009 and 2010. The lease year is the calendar year as set forth in the agreement.

Methodology

To accomplish our objectives, we performed the following procedures:

- Interviewed appropriate Parks and Recreation personnel overseeing the administration of the lease.
- Obtained and reviewed the lease agreement between the City of Virginia Beach and Stumpy Lake Golf Course Inc. dated January 1, 2008 and identified the provisions regarding payment of rent.
- Obtained lessee's computations of the monthly lease payments and the required backup for the lease years 2008, 2009 and 2010.
- Re-computed the payments based on the lessee's reported gross revenue they used to calculate the payments.
- Traced the lease payments into InSITE, agreed them to the lessee calculated amount, and verified whether required amount was transferred to a separate account for future capital expenditures as required.
- Reconciled reported gross revenue by which the lessee calculated the lease payments (2008, 2009, and 2010) with the lessee's detailed general ledger revenue and the revenue reported on the lessee's Federal tax return to gain assurance that all gross revenue required to be included in the lease calculation was included.



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- Scanned the lessee's general ledgers for 2008, 2009 and 2010 for possible netting of gross revenues, exclusion of revenues required to be reported, and other unusual entries effecting the calculation of rent due the City of Virginia Beach.
- Verified that the lessee made the required capital expenditures as specified in the lease agreement.
- Identified other significant lease provisions requiring lessee performance and verified compliance.

Standards

Our audit was conducted in accordance with generally accepted government auditing standards. The Office of the City Auditor reports to City Council through the Audit Committee and is organizationally independent of all City Departments. This report will be distributed to the City's Audit Committee, City Council, City Manager, and appropriate management within the City of Virginia Beach and Virginia Beach City Public Schools. This report will also be made available to the public.



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Background

The City of Virginia Beach acquired the Stumpy Lake property through a condemnation settlement with the City of Norfolk on June 14, 2001. Stumpy Lake Golf Course Inc. was the tenant in possession of the property at the time of the acquisition. The prior lease expired December 31, 2002 but allowed for continuation under the same terms on a month-to-month basis for up to five years while the City of Virginia Beach considered its long-term options and plans for the property.

Beginning January 1, 2008, the City of Virginia Beach executed a new lease with Stumpy Lake Golf Course Inc. to operate and maintain the property as a golf course. The term of the new lease is January 1, 2008 through December 31, 2017. The lessee has the option to extend the term of the lease for two terms of five (5) years each.

The monthly rent amount the lessee is required to pay the City of Virginia Beach is defined in Section 3 of the lease as follows:

“Rent” shall be as follows:

- A. *Ten percent (10%) of gross revenues for the month , with gross revenues defined as all revenues from green fees, tournaments, golf outings, memberships, cart rentals , driving range, and food and beverage until cumulative monthly gross revenues exceed nine hundred thousand (\$900,000) in a lease year. Thirty percent (30%) of the ten percent (10%) will be placed in a separate account to be used of the City of Virginia Beach for capital improvements at the Property. Lessee may request the City utilize these segregated funds for specific capital improvements at the Property, however the final decision shall remain with the City.*
- B. *Ten percent (10%) of gross revenues for the month, in the event that cumulative gross monthly revenues exceed nine hundred thousand dollars (\$900,000) in a year.*
- C. *Twelve percent (12%) of gross revenues for the month, in the event that cumulative gross revenues exceed one million dollars (\$1,000,000) in a year.*



Section 10 of the lease requires the lessee, and the City, to make certain capital improvements to the property:

“The lessee agrees to invest within the first two years of the lease a minimum of \$545,000 toward capital improvements on the Property.” Note: Section 10 also gives specific minimum amounts for various areas of improvements.

“During years 3-10 an additional \$250,000 will be invested in capital improvements by Lessee to maintain the course at a Tier 1 status or better.”

“The City shall contribute the sum of \$300,000 for capital improvements to the Property (the City Improvements”). This contribution will be made after the Lessee has made at least \$300,000 in improvements as set for immediately above.”

Other significant provisions in the lease agreement are as follows:

- The lessee sets the revenue fee structure (mainly green fees and electric cart rental) for the golf course.
- The lessee pays all taxes and utilities.
- The lessee must maintain and repair the property.
- The lessee must submit an annual maintenance plan to be approved by the City of Virginia Beach.
- If the lessee intends to make capital improvements at their own cost, they must first obtain approval from the City of Virginia Beach. Any such improvements become the property of the City of Virginia Beach upon termination of the agreement.
- Submit an annual summary of course improvements and a plan for improvements for the succeeding year.
- The lessee owns all equipment that does not become affixed to the property.
- The City of Virginia Beach has the right to audit all the lessee’s books and records.
- The lessee must include the following monthly reports with the monthly lease payment: (1) profit and loss statement, (2) report of rounds played, (3) sales tax report of prior month.
- The lessee must employ a certified Class A Superintendent and a Class A Golf Professional.
- The lessee must furnish a fidelity bond with a \$100,000 limit and \$50,000 per loss limit.
- The lessee must maintain stated insurance levels.
- The lessee will promote golf as a recreational activity to include free access at reasonable times to Virginia Beach City High School Teams for supervised practice and scheduled matches during the golf season.
- The lessee shall also accommodate private high school teams at the standard discounted youth rate.



Results:

LEASE PAYMENTS

Lessee Overpayment

Finding #1: From recalculating the rent from the gross revenue *reported* by Stumpy Lake Golf Inc. for 2008, 2009 and 2010, we determined that the lessee overpaid the City of Virginia Beach (underpayments are addressed below) in 2010 by \$1,048. *During* the month of November of 2010 the lessee exceeded the \$1,000,000 threshold. The lessee applied the 12% rate (rate to be applied for revenue exceeding \$1,000,000 in any given lease year) to *all* of the November gross revenue rather than prorating it. The lease is clear concerning this issue on page 4 saying “*When the \$900,000 or the \$1,000,000 revenue is reached in the middle of a month, any revenues earned prior to the mark shall be multiplied times the lesser percentage and any earned revenues earned in excess of the mark shall be multiplied times the higher new percentage.*” When recalculating the November revenue prorating and using the correct percentages, it was determined the lessee overpaid the City of Virginia Beach by \$1,048.

	2008	2009	2010
Stumpy Lake Golf Inc.’s Self-Reported Gross Revenue for Rent Calculation	\$ 1,117,958	\$ 985,247	\$ 1,032,595
Annual Rent Calculation:	\$ 1,000,000	\$ 985,247	\$ 1,000,000
	x .10	x .10	x .10
(10% on first \$1,000,000)	\$ 100,000	\$ 98,525	\$ 100,000
	\$ 117,958		\$ 32,595
	x .12		x .12
(12% over \$1,000,000)	\$ 14,155	\$ 0	\$ 3,911
Total Calculated Annual Rent	\$ 114,155	\$ 98,525	\$ 103,911
Total <i>Calculated & Paid by Lessee</i>	\$ 114,155	\$ 98,525	\$ 104,959
Difference	\$ 0	\$ 0	\$ 1,048

Recommendation: We informed the lessee of the error and they agreed that it was calculated incorrectly. We will accumulate all of the findings affecting the lease payments, netting this overpayment with the lessee underpayments cited in table 2 located on page 8.



Lessee Underpayments

The most significant risk to the City of Virginia Beach involving the lease is the fact that the lessee calculates the rental payments themselves based on *their self reported* gross revenue. It should be noted that most of the significant revenue streams are required to be subjected to the rent calculation with the exception of merchandise sold (club house). Other very small revenues not included in the calculation are interest, sale of equipment, ATM fees and some small miscellaneous items.

To gain assurance that the lessee was including all gross revenues in the rent calculation as required by the lease we reconciled (for 2008, 2009 & 2010) gross revenue *reported and used in their calculation* with the lessee's detailed general ledger and federal income tax returns. We also scanned the general ledger for evidence of any netting of revenues against expenses or hidden revenue accounts and/or transactions. From those procedures we found the following tournament revenues which were not included in the rent calculation and should have been included in the gross revenues.

Finding #2: Section 3 of the lease defines gross revenues for rent calculation purposes as "***all revenues from green fees, tournaments...***" In 2010 we found one tournament, the Troy Merritt Tournament, where the tournament fees of \$3,400 had been recorded in a liability account - #2570 Accounts Payable Deposits - and thus were never included in the rent calculation. Also in 2010, in revenue account #49800, Tidewater Amateur Tournament, the lessee paid rent on the *net* tournament amount of \$3,148 (offset with expenses) as opposed to the required *gross* tournament revenues of \$11,570.



Accumulated Findings Affecting Rent for 2008, 2009 and 2010

Findings Affecting Rent	Rent Adjustments	Reason for Adjustment
#2 – 2010 Tidewater Amateur Tournament	\$8,422	Paid Rent only on net of \$3,148 instead of the gross of \$11,570
#2 – 2010 Troy Merritt Tournament	\$3,400	Tournament revenue booked in liability account instead of a revenue account and thus never included
Total Tournament Gross Revenue Excluded	\$11,822	Revenue exceeded \$1,000,000 threshold in 2010
2010 Marginal Rate	x 12%	
Total Underpayment	\$1,419	
#1 – Overpayment of November 2010 Rent from Paying Entire Month at 12%	(\$1048)	November 2010 was the month that the annual 2010 gross revenue exceeded \$1,000,000 and accordingly the rent rate moved from 10% to 12%. The Lessee incorrectly paid the city 12% for the entire month instead of prorating and paying 10% up to the \$1,000,000 threshold
Total Due City	\$371	

Note: The lessee agreed with these findings affecting rent due the City and paid the City the net amount of \$371 prior to the issuance of this report.



Segregation of Rent for Future Capital Costs

Section 3 of the lease requires the City to set aside in a separate account 30% of the 10% rent on the first \$900,000 gross revenues each year for future capital needs. The section reads, *“Thirty percent (30%) of the ten percent (10%) of rent (up to the first \$900,000 annually of gross revenue) will be **placed in a separate account** to be used at the discretion of the City of Virginia Beach for capital improvements at the Property.”*

Finding #3: We were able to trace the receipt of each of the monthly rent checks into the two revenue accounts, from January 2008 through June 2010, in account 175.11053.414199 and from July 2010 to the present they are booked in 151.11054.414199. However, the lease requirement in Section 3 states 30% of the 10% rent be *“placed in a separate account”*. This has not been done for the first three lease years of 2008, 2009 and 2010. Parks and Recreation management indicated they are aware of the requirement and have been in communication with the Department of Finance concerning this issue.

Recommendation: To be compliant with this requirement, we recommend contacting the Department of Management Services and the Department of Finance to segregate into a separate account the required amount of \$81,000 (\$90,000 x 30% x 3years) for 2008, 2009 and 2010. For future years, the 30% should be transferred at the end of the lease year annually and placed in the separate account.



CAPITAL EXPENDITURES

Section 10 of the lease requires the lessee and the City of Virginia Beach to make certain minimum capital expenditures over set time frames. The following clauses are from section 10.

*“The **Lessee** agrees to invest within the first two years of the lease a minimum of \$545,000 toward capital improvements on the Property”*

*“The **City** shall contribute the sum of \$300,000 for capital improvements to the Property (the “City Improvements”) This contribution will be made after the Lessee has made at least \$300,000 in improvements as set for immediately above.”*

*“During years 3-10 an additional \$250,000 will be invested in capital improvements by **Lessee** to maintain the course at a Tier 1 status or better.”*

We were able to verify that the lessee far exceeded the minimum amount of capital expenditures of \$545,000 during the first two lease years of 2008 and 2009. We also verified the City of Virginia Beach made its required \$300,000 capital contribution.

OTHER LEASE PROVISIONS

In addition to the lease payment and capital contribution requirements of the lease, we identified other significant provisions and we tested for compliance as well. Those provisions are as follows:

- The lessee must submit an annual maintenance plan to be approved by the City.
- The lessee must include the following monthly reports with the monthly lease payment: (1) profit and loss statement, (2) report of rounds played,(3) sales tax report of prior month.
- The lessee must employ a certified Class A Superintendent and a Class A Golf Professional.
- The lessee must furnish a fidelity bond with a \$100,000 limit and \$50,000 per loss limit.
- Maintain stated insurance levels.
- Submit an annual summary of course improvements and a plan for improvements for the succeeding year.

We were able to verify that the lessee performed the above lease requirements without exception.



Conclusion

Based on our review, with the exception of the findings noted above, the lessee, Stumpy Lake Golf Course Inc. was in compliance with the lease dated January 1, 2008 for the first three lease years of 2008, 2009 and 2010. The Department of Recreation will begin to segregate thirty percent (30%) of the ten percent (10%) rent on the first \$900,000 of gross revenue for any lease year to be in compliance with the lease.

Acknowledgements

We would like to thank the lessee, Stumpy Lake Golf Course Inc. and the Department of Parks and Recreation for their cooperation and responsiveness to our requests during the review and for their receptiveness to questions, recommendations and suggestions. It should be noted that the lessee maintained exceptional records for the golf course's operations.



City of Virginia Beach

DEPARTMENT OF PARKS AND RECREATION
757-385-1100
FAX (757) 385-1130
TTY: 711

VBgov.com
MUNICIPAL CENTER
BUILDING 21
2408 COURTHOUSE DRIVE
VIRGINIA BEACH, VA 23456

INTER-OFFICE MEMORANDUM

DATE: April 12, 2011

TO: Lyndon S. Remias, City Auditor

FROM: Mary J. Cole, Acting Director of Parks and Recreation

SUBJECT: Response to 2011 Audit of Stumpy Lake Golf Course Lease

I first would like to thank you and Mr. Ford for your professionalism and customer service skills demonstrated throughout this process. From beginning to end, there has been the sense that all parties involved were working toward a common goal. This would not have been possible without your guidance and expertise. The Stumpy Lake Golf Course Lease Audit was an efficient process that allowed all groups involved to adjust and improve their current business practices.

The City of Virginia Beach Department of Parks and Recreation agrees with the findings and recommendations presented within this report. All issues have been resolved or are currently being addressed.

cc: Kevin Bennington, Parks and Recreation