



Memorandum



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To: Hon. Carlos A. Gimenez, Mayor, Miami-Dade County
Hon. Joe A. Martinez, Chairman, Board of County Commissioners
and Members, Board of County Commissioners

From:  Christopher Mazzella, Inspector General

Date: May 31, 2012

Subject: Transmittal and Executive Summary of the OIG's Final Report of our *Audit of the Agreements Between Miami-Dade County and Basketball Properties, Ltd., et.al. to Operate the American Airlines Arena*; Ref. IG11-34

Attached please find the above-captioned final audit report issued by the Office of the Inspector General (OIG). This audit covered Miami-Dade County's (County) administration of the agreements between the County and Basketball Properties, Ltd., et.al. (BPL) to manage and operate the American Airlines Arena (Arena). Our audit encompassed an examination of the evolution of the agreements, the County's contract administration activities through the years, and BPL's accounting records and financial reporting.

This report, as a draft, was provided to County administrators charged with Arena contract management and to BPL. Responses were received from both parties, and they are incorporated into the final report as Appendix A and B. Our final report includes summations of the responses received, as well as finding and recommendation-specific responses and OIG rejoinders thereto, which are set forth at the end of each finding or recommendation .

In accordance with Section 2-1076(d)(2) of the Code of Miami-Dade County, the OIG requests that the County administration provide a status report in 90 days on the issues identified in the report and on its implementation of our recommendations. We request to receive this report on or before August 29, 2012.

Lastly, the OIG would like to thank both County and BPL personnel for making themselves and their records available to us in a timely manner and for the courtesies extended to the OIG during the course of its review.

For reading convenience, we have attached an executive summary of the report.

Attachment

cc: Mr. Eric Woolworth, President, The HEAT Group/Basketball Properties, Ltd.(THG/BPL)
and THG/BPL Executives previously furnished with the draft report
Edward Marquez, Deputy Mayor, Miami-Dade County
Lester Sola, Director, Internal Services Department
Cathy Jackson, Director, Audit and Management Services
Charles Anderson, Commission Auditor

EXECUTIVE SUMMARY

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Arena Background

In 1996, a non-binding letter of intent was signed concerning the potential construction of a new arena in order to keep the Miami Heat (Heat) in town. This arena was intended to primarily accommodate Heat basketball games; however, it would also be available for various other events. Shortly thereafter, a partnership, Basketball Properties, Ltd. (BPL), was formed between the Heat organization and a Heat affiliate. BPL appears to have been created in anticipation of the development and management of this proposed arena.

In April 1997, the Miami-Dade Board of County Commissioners (BCC) approved the execution of several agreements detailing the terms related to, among other things, the development and management of a new arena. The arena was to be financed by the newly formed Heat Group partnership (BPL), but it also was to be a County-owned facility, built on County land and subsidized by the County on an annual basis. During its deliberations on the proposed agreements, the BCC also specifically addressed issues pertaining to the County potentially sharing 40% of excess cash flow derived from arena operations; the feasibility of allowing the Heat to perform the bookkeeping for the arena; and the sale of naming rights of the arena.

Later that month, four Agreements (Management, Assurance, License, and Development) were executed by the County and BPL (and partners), in order to construct the new arena (Arena) and subsequently manage it, among other things. Subsequently, these Agreements have been revised by eight amendments in the years following. The OIG audit focuses on the Management Agreement.

In the fall of 1997, the County purchased approximately 17 acres of waterfront property from the City of Miami for \$37.6 million to be the site for the Arena. Construction of the Arena began in early 1998, and less than two years later the Arena officially opened its doors on December 31, 1999. The Arena is owned by the County, sits on County-owned land, but is managed and operated by BPL. BPL (and partners) provided the financing for the Arena and has been recovering its investment through annual amortization of the cost of the Arena from net cash flows. Through fiscal year ended June 2010, BPL has cumulatively deducted \$156.6 million for Arena cost amortization (approximately \$15 million annually) against the Arena Distributable Net Cash Flow. During this same period, the County has subsidized Arena operations amounting to \$72.2 million (\$6.4 million per year plus a \$5 million pre-opening subsidy).

The OIG audit focused on the County's administration of the Management Agreement and on BPL's accounting records and financial reporting for its fiscal years ended June 30, 2005 through June 30, 2010. Under the terms of the Management Agreement, any excess cash flow derived from the operations of the Arena is distributed to BPL, with one exception. The Management Agreement contains terms that detail a computation to be performed that could result in a share of profits between BPL and the County if Arena operations achieve a certain amount of excess cash flow.¹ This provision

¹ The OIG, at times, uses the terms "profit" to describe that amount that would be available for distribution, which is labeled as Arena Distributable Net Cash Flow, pursuant to the Management Agreement.

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calls for BPL to retain the first \$14 million of “Arena Distributable Net Cash Flow” (Net Cash Flow). Net Cash Flow in excess of \$14 million is to be distributed between BPL and the County, with 60% of the excess amount going to BPL and the remaining 40% to the County. As of fiscal year 2011, Arena operations have generated no Net Cash Flow. As a result, there has been no distribution, in any year, either to BPL for the first \$14 million of Net Cash Flow or to the County for its 40% share of any Net Cash Flow in excess of \$14 million.

Audit Findings

Overall, the OIG audit found that the County has been poorly performing its contract administration functions. This is not to say that the facility has been poorly managed—which we have no reason to believe—but that County administrators assigned the responsibility to oversee the Arena have not taken much of an interest in the past 12 years in administering the Management Agreement and ensuring compliance with its various terms. Our audit issues are chiefly attributed to a fundamental lack of communication between the designated “County Representative” and BPL personnel regarding its administration, management, and operation of the Arena. BPL stated in its response to the OIG’s draft report that it engaged a lobbyist as its liaison to facilitate communications between itself and the County. However, none of the designated “County Representatives” that we spoke to, when queried specifically about communications with BPL, mentioned contact with BPL’s liaison. At least at the critical contract administration level (budget submission, tendering notices of legal action, financial reporting, capital expenditures, etc.), we found nothing to evidence this liaison’s involvement. Collectively, the lack of communication by both parties is the overarching cause that has contributed, we believe, to many (if not all) of our report issues.

Our audit results are reported in four sections: *Section 1 BPL Budgets and Year-End Financial Reporting*; *Section 2 Management Agreement Terms*; *Section 3 Arena Revenues*; and *Section 4 Operating Expense Allocations and Costs*. Each section has its own findings and recommendations.

In Section 1, we focused on three key issues: BPL’s Schedules of Management Agreement Computations, BPL’s Operating and Capital Budgets, and BPL Financial Report Comparisons. First, the Schedules of Management Agreement Computations is the key document produced by BPL showing whether the County will receive a share of “Arena Distributable Net Cash Flow” (Net Cash Flow). Based on our interviews of County and BPL personnel, we determined that the County has never seriously studied this document’s content nor approached BPL to discuss how it prepares this document. As a result, the County has little idea about the underlying conditions and financial issues that, to date, have resulted in the Arena’s failure to generate sufficient reportable Net Cash Flow that would have allowed the County to share in the distribution of Arena excess cash flow.

Relating to the budgets, we noticed that the Annual Operating Budget was consistently being submitted late with no repercussion by the County. As for the Annual Capital Budget (which is required to be submitted by the contract), County staff didn’t even realize—until the OIG pointed it out—that the County wasn’t receiving one. Next, for the budget that it was receiving, albeit late, we determined that the County’s review process

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was inadequate. There was no leadership by the County to establish a meaningful contract administration function that could have provided insightful budget review. For example, our report illustrates budget variances of over 100% from year-to-year in such categories as: Public Relations Fees, Legal Fees/Lobbyist, Advertising/Marketing/Sales Contractual Bonuses, and Satellite/Cable Subscription fees. Our audit, however, revealed no evidence that County staff or the designated "County Representative" questioned these variances. Two noteworthy factors contributing to this condition were that the contract administration function repeatedly moved from one "County Representative" to another and there were no guidelines for staff to follow that prescribed how to accomplish an effective review.

The annual budget review and approval process is a critical contract administrative function because it represents the County's best opportunity to add input into BPL's planned Arena management and operations for the coming year. Notwithstanding the County's ambivalence, even if the County had wanted to review the budget, the five-business day deadline to conduct reviews per the terms of the contract did not give the County adequate time to complete a meaningful review regardless of when the budget was submitted. We find this five-day turn around time to be unreasonable.

Finally, financial report comparisons are quite difficult due to the complexity of the contractually obligated reports issued by BPL along with the readily noticeable differences in report formats. These conditions would have limited the County's (or any other reader's) ability to obtain useful and relevant data. For example, with the information provided by BPL to the County, BPL budget items and amounts cannot be easily compared to corresponding items and amounts in its audited consolidated financial statements. In turn, these items and amounts are not readily comparable to those items and amounts reported in BPL's Schedules of Management Agreement Computations. To accomplish these comparisons, the County must have access to BPL's trial balance, general ledger, journal entries, and supporting worksheets. The lack of comparability is readily visible to any observer who would have taken the time to lay side-by-side BPL's Annual Operating Budget (the only BPL budget located in County files) next to BPL's Schedules of Management Agreement Computations and audited consolidated financial statements.

In Section 2, we discuss several key contractual obligations that the County has not been enforcing and other contract rights that it has not been exercising. We observed that the County has not taken any action to address BPL's continued late submission of its Annual Operating Budget. Moreover, the County didn't even notice—until OIG auditors pointed it out—that the County was not receiving an Annual Capital Budget (about \$3 million annually). Likewise, the County was not receiving annual budgetary information on equipment lease expenses (about \$2.3 million annually).

The failure to submit an Annual Capital Budget is a concern to OIG auditors. First, BPL funded its capital expenses on a pay-as-you-go basis, instead of annually funding an Arena Capital Replacement Reserve Account. Second, since the County was not receiving a Capital Budget, it had no idea of the amount BPL was intending to spend or what it was intending to spend the money on. Arena operating expenses are deducted against the Net Cash Flow, and capital expenses are included in that calculation to the extent that they are listed in the approved Annual Capital Budget or are otherwise approved by the County

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Representative outside of the annual budget approval process. The OIG learned that while BPL did not submit its Annual Capital Budgets to the County, it nevertheless had prepared them. Our review of these budgets compared to the reported amount spent revealed that BPL spent anywhere from \$127,640 (fiscal year 2008) to \$2,549,810 (fiscal year 2007) more on capital expenditures than shown in its Annual Capital Budget. During our audit period of six fiscal years, BPL spent more than its capital budget on four occasions, totaling \$3.3 million. Even if the County had received BPL capital budgets and approved them during the cited years, these excess expenditures would not have been allowable outside of the approval process, and thus are being questioned by OIG auditors. This is not a matter of reimbursing costs to the County, but an issue of whether these costs may have been contractually deducted against the Net Cash Flow for the years incurred. Had these excess expenditures been excluded from the Net Cash Flow, there would have been more funds available to pay off the Manager Loans. The OIG recommends that the County claim these unapproved amounts via an adjustment to a future Schedules of Management Agreement Computations.

In addition, the OIG notes several other shortcomings in Section 2. The County has not exercised its contractual rights to request that BPL provide it with an updated personal property and equipment inventory listing. As of June 30, 2010, there was about \$5.1 million of property and equipment. In addition, the County has not requested that an independent qualified engineer be engaged to inspect the Arena, which cost over \$200 million to construct, and provide a written report of its inspection to the County and BPL. Furthermore, the County should require that BPL adhere to its contractual requirement to provide written notifications to the County of legal actions and advise the County of the progress of those proceedings.

In Section 3, we note that the County does not have an adequate understanding of Arena operations in the context of what comprises Arena Revenues. Issues affecting Arena Revenues that we believe the County should have some practical understanding of include Premium Inventory seating ticket sales contracts, Arena configuration and usage, non-Heat event usage, and third-party advertising.

Lastly, in Section 4, the OIG highlights some problematic issues that we observed related to BPL's accounting practices and financial reporting that have gone unaddressed by the County. In large part, we attribute these issues to the County's ambivalence towards exercising (or enforcing) the Agreements' terms and conditions. We determined that BPL's recorded expense allocations have been inconsistent through the years and are not always supported by authoritative accounting records. We also determined that certain of its expenses should be questioned by the County as to whether they are appropriately included when calculating the "Arena Distributable Net Cash Flow." Some of these expenses include political and charitable contributions, associational dues and sponsorships, lobbying expenses (serving as a "liaison" to the County), and executive compensation. We believe many, if not all of the noted conditions, would have been noticed had the County exercised its rights as outlined in the Agreements.

The OIG has set forth a number of recommendations in the report that addresses our findings.

Miami-Dade County

Office of the Inspector General



Final Audit Report

**Audit of the Agreements Between Miami-Dade County and
Basketball Properties, Ltd., et. al., to Operate the American Airlines Arena**

IG11-34
May 31, 2012

MIAMI-DADE COUNTY OFFICE OF THE INSPECTOR GENERAL
OIG FINAL AUDIT REPORT
*Audit of the Agreements Between Miami-Dade County and
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I. INTRODUCTION

The Miami-Dade County Office of the Inspector General (OIG) conducted an audit of the agreements between Miami-Dade County (County) and Basketball Properties, Ltd. (BPL), et. al.,¹ to operate the American Airlines Arena (Arena). Our audit encompassed an examination of the evolution of the agreements and the County's contract administration activities through the years. In addition, we reviewed BPL's accounting records and financial reporting for its fiscal years ended June 30, 2005 through June 30, 2010; although, when deemed necessary, we examined records and activities both before and after this period.

Our audit results are reported in four sections. Each section has its own findings and recommendations, and may contain supplemental background information, objectives, scope, and methodology.

SECTION 1	BPL BUDGETS AND YEAR-END FINANCIAL REPORTING
SECTION 2	MANAGEMENT AGREEMENT TERMS
SECTION 3	ARENA REVENUES
SECTION 4	OPERATING EXPENSE ALLOCATIONS AND COSTS

In addition, this report contains three schedules that provide supplemental information regarding the issues addressed within the report:

Schedule A	Timeline of Events Related to the Development and Management of the American Airlines Arena
Schedule B	Summary of the Four Agreements (Management Agreement, Assurance Agreement, Development Agreement, and License Agreement)
Schedule C	BPL Financial Reports Comparisons for Fiscal Year 2010: Operating Budget, Capital Budget, Audited Financial Statements, and Schedules of Management Agreement Computations

The report also includes an Appendix A and an Appendix B, which contain the County's and BPL's responses to the draft report.

¹ Basketball Properties, Ltd. (BPL) was formed in 1996 between Basketball Properties, Inc. and the Miami Heat Limited Partnership (MHLP) for the purpose of developing, constructing, and managing the American Airlines Arena. Basketball Properties, Inc. holds a 1% general partnership interest in BPL and MHLP holds the remaining 99% limited partnership interest.

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II. TERMS USED IN THIS REPORT

Agreements	Collective reference to the Development Agreement, Management Agreement, License Agreement, Assurance Agreement, and eight composite amendments thereto between the County, BPL, and the Miami Heat Limited Partnership
Arena	American Airlines Arena
BCC	Miami-Dade County Board of County Commissioners
BPL	Basketball Properties, Ltd. (the Arena “Manager”)
County	Miami-Dade County
ISD	Miami-Dade County Internal Services Department
MHLP	Miami Heat Limited Partnership (the “Team”)
Net Cash Flow	Arena Distributable Net Cash Flow (“profit”)
OIG	Miami-Dade County Office of the Inspector General
PWC	PricewaterhouseCoopers, LLP

III. RESULTS SUMMARY

Introduction

The Arena is a County-owned facility that is managed and operated by BPL, pursuant to the Agreements executed by the County and BPL (and partners) in 1997, as revised by eight amendments in the following years. The Arena officially opened on December 31, 1999 and the Miami Heat played its first game in the new Arena on January 2, 2000. The Agreements’ duration is for 30 years plus two five-year options to renew.

In all the years since the execution of the Agreements and the start-up of Arena operations, the County has not put much emphasis on or effort into understanding the Agreement’s terms and conditions or learning about Arena operations and BPL’s administrative responsibilities and related financial reporting.

The County’s lack of performance through the years is reflected in its disregard for certain contract enforcement responsibilities and its failure to exercise certain contract terms. For example, the County allowing BPL to submit its Annual Operating Budget late every year and not submit its Annual Capital Budget at all, were serious oversights. The annual budget review and approval process is a critical contract administrative function because it represents the County’s best opportunity to add input into BPL’s planned Arena management and operations for the coming year.

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The County's failure to perform an in-depth review of BPL's operations and financial reporting is evidence of its lack of enthusiasm towards exercising its contract rights. Consequently, as our audit revealed, a number of questionable expenses were charged against Arena Revenues, thus lessening the County's prospects of receiving its proportional share of Arena "profits" (i.e., Arena Distributable Net Cash Flow, as derived pursuant to the Schedules of Management Agreement Computations).

It is inexplicable why the County allowed these conditions to develop, given the fact that both the County and BPL, an unproven start-up company, were unfamiliar with their respective contract administration responsibilities and the BCC's expressed concern about allowing BPL to be the Arena bookkeeper.² We believe it would have been prudent for the County to have taken a more active role in ensuring that both its own and BPL's contract administration were adequate.

Compounding this situation, BPL did not make much effort to communicate with the County regarding its administration, management, and operation of the Arena. Collectively, the failure of both parties to better communicate and cooperate is the overarching condition that has contributed, we believe, to many (if not all) of our report issues.

The importance of both parties communicating (over and above the required financial reporting) and cooperating about Arena administration, management, and operations is self-evident. This is especially true because BPL, as noted earlier, was a start-up entity without prior arena management experience. It is perplexing that the County did not make a greater effort to reach out to BPL, and BPL to the County, about how this valuable County asset could best be managed and operated as a first-class facility.

The County also should be more informed about the Arena Revenues that BPL uses in its Schedules of Management Agreement Computations. Additionally, there have been some key contractual obligations unfilled, on the part of both parties, and some problematic issues related to BPL's accounting practices and financial reporting that have gone unaddressed by the County.

² BCC Agenda Item 6B6 Substitute, Summary of Principal Changes to Proposed Arena Agreements (Legislative File # 971201). BCC Members expressed concern about "creative accounting" and questioned the feasibility of allowing the bookkeeping to be maintained by the Heat. The County Manager (at the time) reassured the Commission that the County has extensive audit rights to ensure that the books are kept properly.

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SECTION 1 BPL BUDGETS AND YEAR-END FINANCIAL REPORTING

To start with, the County has little idea of the financial complexities related to BPL's Schedules of Management Agreement Computations. This is the key document produced by BPL showing whether the County will receive its fair share of "Arena Distributable Net Cash Flow" (Net Cash Flow). Based on our interviews of County personnel, we determined that the County has never seriously studied this document's content nor approached BPL to discuss how it prepares this document. As a result, the County has little idea about the underlying conditions and financial issues that, to date, have resulted in the Arena's failure to generate sufficient reportable Net Cash Flow from operations that would have allowed the County to share in Arena profits.

We determined that the County's review process of BPL's annual budget was inadequate. There was no leadership by the County to establish an effective contract administration function that would provide a meaningful budget review.

Two factors compounded this condition. One was that the contract administration function repeatedly moved from one County individual to another. Thus, no one ever had a real opportunity to take ownership of this function. The second factor was that there were no guidelines for staff to follow that prescribed how to accomplish an effective review. As a result, the County's review process was cursory, at best. We observed that the County, after more than ten years, has little understanding of the complexity of Arena operations or familiarity with the content and format of BPL's submitted financial reports.

Notwithstanding the deficiencies of the County's budget review, because the County took no action when BPL did not timely submit its Annual Operating Budget and did not submit its Annual Capital Budget at all, the County effectively precluded itself from performing meaningful budget reviews. Even with timely submitted budgets and a meaningful review process, the County would have been challenged to complete a thorough budget analysis. The five-business day deadline for budget review is unreasonable and does not allow the County time to complete a meaningful review regardless of when the budget was submitted.³

Moreover, during our audit period, BPL spent anywhere from \$127,640 (fiscal year 2008) to \$2,549,810 (fiscal year 2007) more on capital expenditures

³ Management Agreement Section 4.15.1 requires BPL to submit its operating budget to the County no later than 45 days prior to the commencement of a new fiscal year and gives the County five business days to respond in writing and, if no response is provided, the budget is deemed approved.

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than shown in its Annual Capital Budget. During our audit period of six fiscal years, BPL spent more than its capital budget on four occasions, totaling \$3.3 million. Even if the County had approved BPL's capital budgets during the cited years, these excess expenditures would not have been allowable Arena Operating Expenses, pursuant to the Management Agreement.⁴

Another issue that would have impeded the County's ability to review BPL's financial reports is their sheer complexity. In short, BPL's financial report formats are not easily comparable. This condition would have limited the County's (or any other reader's) ability to obtain useful and relevant data. For example, with the information provided by BPL to the County, BPL budget items and amounts cannot be compared to corresponding items and amounts in its audited consolidated financial statements. In turn, these items and amounts are not comparable to those items and amounts reported in BPL's Schedules of Management Agreement Computations.

To accomplish these comparisons, the County must have access to BPL's trial balance, general ledger, journal entries, and supporting worksheets. The lack of comparability is readily visible to any observer who would have taken the time to lay side-by-side BPL's Annual Operating Budget (the only BPL budget located in County files) next to BPL's Schedules of Management Agreement Computations.

SECTION 2 MANAGEMENT AGREEMENT TERMS

Regarding key contractual obligations that were unenforced yet involved substantial expenses, we observed that BPL has not been providing its Annual Operating Budgets to the County at least 45 days prior to the start of a new fiscal year. Furthermore, for our audit period, BPL could not demonstrate that it has provided the County with its Annual Capital Budgets and the County cannot demonstrate that it has ever received BPL's Annual Capital Budgets (about \$3.0 million annually) or BPL's annual equipment lease expenses (about \$2.3 million annually). Additionally, BPL has not been consistently providing written notifications to the County of legal actions nor has it been updating the County on the progress of such actions.

Moreover, the County has not exercised its contractual rights to request that BPL provide it with an updated personal property and equipment inventory listing. As of June 30, 2010, there was about \$5.1 million of property and equipment. In addition, the County has not requested that an independent qualified engineer be engaged to inspect the Arena and provide a written report

⁴ Management Agreement, Exhibit 1, Definitions 45, Arena Operating Expenses

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of its inspection to the County and BPL. Furthermore, since Arena operations began, the County has not performed an in-depth review of BPL's records and management of Arena operations. It was not until the OIG's initial inquiries in July 2011, leading to the OIG's audit, which began several months later, that a County entity first performed an in-depth review of BPL's Arena administration, management, and operations.

SECTION 3 ARENA REVENUES

Another mostly unknown factor to the County's understanding of these Agreements and Arena operations relates to what comprises Arena Revenues. Issues affecting Arena Revenues that the County should have some practical understanding of include Premium Inventory seating ticket sales contracts, Arena configuration and usage, non-Heat event usage, and third-party advertising. The County's hands-off approach to an operation that now generates revenues of more than \$60 million a year is perplexing, especially an operation that has yet to produce sufficient profits to result in profit sharing by the County.

SECTION 4 OPERATING EXPENSE ALLOCATIONS AND COSTS

We also observed some problematic issues related to BPL's accounting practices and financial reporting that have gone unaddressed by the County. In large part, we attribute these issues with the earlier mentioned County disregard for enforcing the Agreements' terms and conditions. We determined that BPL's recorded expense allocations have been inconsistent through the years and are not always supported by authoritative accounting records. We also determined that certain of its expenses were inappropriate deductions against the Net Cash Flow. Some of these expenses include political and charitable contributions; associational dues and sponsorships; lobbying expenses (serving as a "liaison" to the County); and executive compensation. We believe many, if not all of the noted conditions, would have been noticed had the County exercised its rights, as outlined in the Agreements.

IV. AUDITEE RESPONSES AND OIG REJOINDERS

We provided a copy of this report, as a draft, to Miami-Dade County and to BPL for their discretionary written responses to our audit. Responses were received from the County's Internal Services Department (ISD) and from BPL. Their responses are attached to this report, as Appendix A and Appendix B, respectively. This section of the final report includes general summations of the responses received and our rejoinders thereto. Throughout Section VIII of the report ("Findings and Recommendations"), finding-specific and recommendation-

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specific responses, and OIG rejoinders thereto, are set forth at the end of each finding and/or set of recommendations.

Miami-Dade County Response

The County noted that it recognizes the Arena's importance and value for Miami-Dade County and that County Administration "is fully committed to fulfilling [its] contractual obligations and providing the necessary oversight to ensure the facility serves the community as a first-class venue." The County, without comment on our findings, responded favorably to each of the 23 recommendations. The County concludes that it "look[s] forward to meeting with the OIG and BPL to review the various audit documents."

OIG Rejoinder

The OIG is pleased with the County's response and hopes that it signals a new era in County contract administration related to this valuable asset.

BPL Response

BPL begins its response by commenting on what it thinks is the OIG's "fundamental lack of understanding with regard to three major areas." In brief, BPL states that the OIG does not recognize the overall success of the County's involvement in the Arena in achieving two goals: retaining the Miami Heat basketball franchise and acknowledging the Arena "as a catalyst for the revitalization of the downtown Miami." BPL's second issue is that "The [OIG's] report mischaracterizes the involvement of Miami-Dade County and its administration in overseeing Arena operations as opposed to outlining the close partnership between Miami-Dade County and BPL." Lastly, BPL notes that the report inaccurately refers to "profit" and "profit sharing." BPL states, "These [OIG] references are indicative of a lack of understanding of the complex nature of the relationship as provided for in the Agreements ..."

Furthermore, BPL points out that the OIG failed to highlight the fact that while the County has not yet received a distribution pursuant to the Agreements, neither has BPL received a distribution. Lastly, BPL states that it "continues to bear 100% of the operating risk should [its business] cycle take a downturn."

In the body of its response, BPL makes several comments on our findings in order to clarify the discussed issues and to present its particular points of view. In general, however, BPL agreed with our recommendations, except in two instances. Additionally, BPL notes that it is amenable to exploring several of the

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OIG-suggested contract modifications with the County, and in its response suggests some of its own.

OIG Rejoinder

The OIG strongly disagrees with BPL's comments about what it believes to be the OIG's "fundamental lack of understanding with regards to three major areas." The OIG initiated its audit for the purposes of evaluating the County's contract administration and of BPL's management, operation, and financial reporting related to the subject Agreements. Our intent was never to examine the economic impact to the Miami downtown area generated by the Arena.

Furthermore, we observed no "close partnership between Miami-Dade County and BPL" as it relates to issues and activities that we reviewed. BPL also claims that it has "had countless meetings on numerous issues and varied subjects with the County at all levels of County government since inception." BPL notes that it has retained a lobbyist to serve as its liaison with the County. However, as we describe in our report, there has been very little in the way of a relationship between the two parties that was relevant to contract administration and financial reporting issues .

We also take issue with BPL's characterization of our use of the terms "profit" and "profit sharing" as indicative of the OIG's lack of understanding of the relationship provided for in the Agreements. What we did was to put context into this relationship using more commonly recognized terms, but not without describing that context to the readers of this report.

The OIG also disagrees with BPL's statement that the report fails to acknowledge that BPL, like the County, has never received a distribution from the Net Cash Flow. The report, in fact, spends over five pages (see Section V Background) discussing how neither party (County or BPL) has received a distribution of Net Cash Flow in any given year. This is because BPL's Manager Loans are repaid before any distributions can be made to the County and/or BPL. The cumulative amount of the loans has far outweighed the available Net Cash Flow. TABLE 1 and TABLE 2, as well as several express statements, all serve to highlight this fact.

In addition, BPL's statement that it bears 100% of the operating risk should Arena operations deteriorate is not true. The County is obligated by Agreement to subsidize Arena operations (for the duration of the Agreement) at a rate of \$8.5 million per year. (The County's subsidy has been reduced by \$2.1 million due to the sale of Arena naming rights.) In total, through fiscal year 2010, the County has provided \$72.2 million in annual subsidies, inclusive of a one-time only pre-opening

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subsidy amounting to \$5 million. These subsidies have provided a substantial cushion that significantly mitigates BPL's operating risk. Furthermore, pursuant to the Agreements, 100% of the Arena's operating costs, including BPL personnel payroll costs and benefits, are those items that are first paid using Arena revenues. While there have been years when Arena revenues have not covered Arena operating costs, thereby requiring "manager loans" by BPL and/or partners, these loan amounts are repaid before any distribution to BPL or to the County.

V. BACKGROUND

The BCC approved the County's execution of four agreements with BPL and its partners in April 1997 related to the construction, development, and operations of a professional sports franchise facility that would be located in Miami-Dade County. (See OIG Schedule A for a timeline of events related to the development and management of the Arena.) Additionally, in October 1997, the BCC authorized the County's purchase of approximately 17 acres of City of Miami owned waterfront property for \$37.6 million, in part to be used to locate a new multi-purpose professional sports and entertainment facility, i.e., the American Airlines Arena.

Under the Agreements, BPL would finance and construct this facility, but the facility would be County-owned property. This facility would later be named the American Airlines Arena (Arena) when, in 1999, American Airlines contracted to have its name on the Arena for 20 years, at a fee of \$2.1 million per year. In December 1999, the Arena first opened for business and on January 2, 2000, the Miami Heat played its first basketball game in the Arena.

As discussed in more detail below, the County subsidizes annual Arena operations at a net amount of \$6.4 million per year (\$3.2 million in the first one-half fiscal year of operations). In total, County subsidies have amounted to \$72.2 million, including a pre-opening subsidy of \$5.0 million to offset Arena start-up costs, through fiscal year 2010. Moreover, as part of the computation to derive Arena Distributable Net Cash Flow, upon which the County/BPL profit share is based, BPL is allowed to deduct an amount for Arena Cost Amortization.⁵ This annual deduction amount has ranged from \$8.5 million (in fiscal year 2000, which was only six months) to \$17.5 million, over the ten plus years of Arena operations. In total, this deduction has amounted to \$156.5 million through fiscal year 2010.

⁵ Management Agreement Section 5.1.2.2 defines this cost as the amount necessary to fully amortize the Adjusted Arena Cost in equal monthly installments over the Arena Costs Amortization Period (30 years from operations start date), at the Amortization Interest Rate.

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There is a Management Agreement, a License Agreement, a Development Agreement, and an Assurance Agreement (the Agreements). Since then, there have been eight amendments to the Agreements, the last one being adopted by the BCC in December 2003. (See OIG Schedule B for a summary of the four Agreements).

The OIG found that the Agreements were drafted by BPL's outside counsel and reviewed for legal sufficiency by the County Attorney's Office. The OIG established that a couple of terms in the Agreements were implemented in order to gain acceptance from the County and its residents. First, the financing of Arena construction was assumed by BPL and related parties, even though the County was to own the facility. BPL was to be reimbursed for these costs through an amortization of the Arena adjusted cost over each fiscal year of the term of the Agreements, as discussed earlier. Second, as described later, a provision was included that would allow the County to share in the profits of the Arena if profits met a certain threshold.

As mentioned earlier, one provision of the Management Agreement calls for the County to pay BPL \$8.5 million per year to subsidize ongoing Arena operational and municipal service expenses over its 30-year term. This amount is reduced by the County's sale of naming rights to American Airlines, which amounts to \$2.1 million per year (for a period of 20 years); thus, the net amount to BPL is \$6.4 million annually. Additionally, pursuant to Section 5 and Definition 105 of the License Agreement, MHL P pays a "Use Fee" to BPL every year for the right to use the Arena. This Use Fee is the greater of \$1.5 million per year or 5% of "Ticket Receipts" for home games played in the Arena. Annual Use Fee amounts, over the audit period, have ranged from \$1.5 million (2010) to \$2.2 million (2006).⁶

Under the terms of the Management Agreement, BPL earns any income derived from the operations of the Arena, with one exception. The Management Agreement contains a profit share provision between BPL and the County, if Arena operations achieve a certain amount of Net Cash Flow. The profit share provision calls for BPL to retain the first \$14 million of "Arena Distributable Net Cash Flow" (Net Cash Flow). Net Cash Flow in excess of \$14 million is to be divided between BPL and the County, with 60% of the excess amount going to BPL and the remaining 40% to the County.⁷

⁶ In 2006, the Heat won the NBA championship, thus, there were greater Ticket Receipts. The Use Fee for fiscal year 2011, a year when the Heat played in the NBA championship series, was \$2.8 million.

⁷ Management Agreement Section 5.4.2

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As of fiscal year 2011, Arena operations have generated no Net Cash Flow. As a result, there has been no Net Cash Flow, in any year, to allow BPL to retain some part of the first \$14 million Net Cash Flow due it pursuant to the Management Agreement, or to allow for the 60-40 profit share with the County of Net Cash Flow in excess of \$14 million.

The Management Agreement goes on to describe, in detail, all of the qualifying conditions, calculations, etc., that make up the computation to derive Net Cash Flow. BPL's Schedules of Management Agreement Computations is the final product that it submits to the County summarizing these computations and, thus, determining whether there will be any monies available to be distributed to the County and/or BPL. The determination of Net Cash Flow does not correlate with BPL's net income as reported in its audited Annual Consolidated Financial Statements (Financial Statements). These are two completely separate calculations. For fiscal year 2011, there were no funds available for distribution to either party, according to the cash flow calculation (see TABLE 1). In comparison, BPL's Financial Statements show its net income for fiscal year 2011 to be \$13.2 million.

**TABLE 1 County Profit Share Provision Cash Flow Calculation
FY 2011 Schedules of Management Agreement Computations**

Description	Amount
Arena Revenue	\$62,773,751
Arena Operating Expenses	\$(36,132,758)
MDC Municipal Service Payment	\$3,450,000
MDC Operating Cost Payment	\$2,950,000
<i>Subtotal – Arena Net Cash Flow</i>	\$33,040,993
Arena Cost Amortization	\$(14,419,910)
Arena Capital Replacement Reserve Payment	\$0
Management Fee Payment	\$0
<i>Subtotal – Arena Excess Net Cash Flow</i>	\$ 18,621,083
Deductions [interest accrued on manager loans, management fees & cumulative accrued interest]	\$(1,499,143)
Repayments of Principal on Outstanding Manager Loans	\$(17,121,940)
Total – Arena Distributable Net Cash Flow (Net Cash Flow)	\$0

Note: Amounts derived from Basketball Properties, Ltd.'s Schedules of Management Agreement Computations, as of June 30, 2011, as issued through Pricewaterhouse Coopers LLP, on October 28, 2011.

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One major difference between how BPL calculates its cash flow and net income amounts is that the cash flow calculation includes the accumulated Manager Loans required to fund Arena operations for prior fiscal years. In contrast, the net income amount reported in BPL's Financial Statements takes into account only the current fiscal year's activity. For fiscal year 2011, \$17.1 million was included in the cash flow calculation for repayment of principal on the Manager Loans, and an additional \$1.5 million was included for payment of accrued interest associated with this loan amount, along with unpaid management fees. In total, these two deductions amounted to \$18.6 million.

Pursuant to the Agreements, these amounts must be paid off before there will be any monies available to be distributed to the County and/or BPL. Even after this \$18.6 million deduction, there remains \$9.6 million of outstanding Manager Loans, unpaid management fees, and accrued interest that must be repaid in future years, before there will be any monies available to be distributed to the County and/or BPL.

Another reason for the difference between these two amounts is that the cash flow calculation includes an amount (\$14.4 million for fiscal year 2011) for Arena cost amortization, which is calculated according to terms of the Agreements. In comparison, BPL's Financial Statements include an amount (\$12.1 million for fiscal year 2011) for Arena depreciation and amortization, which is calculated following generally accepted accounting principles.

Significant components of this computation are that it allows a reduction to Arena cash flow for the principal and accrued interest related to Manager Loans⁸ and unpaid Management Fees.⁹ Manager Loans accumulated because once the Arena opened in fiscal year ending June 30, 2000, Manager Loans were used to help fund its early years of operations. Simply stated, for these early years Arena operations costs and other allowable deductions exceeded Arena revenues, i.e., the Arena was running annual deficits. These deficits occurred even though the County paid BPL \$5 million to offset Arena start-up operating costs to be used during fiscal years 2000 - 2002.¹⁰

Because of the deficits, BPL¹¹ used its funds, i.e. Manager Loans, to finance Arena operations, for the first four and one-half years of operations. The outstanding Manager Loan principal balance peaked at approximately \$37.5

⁸ Management Agreement Section 5.2.1

⁹ Management Agreement Section 5.1.4

¹⁰ Management Agreement Section 5.6.4

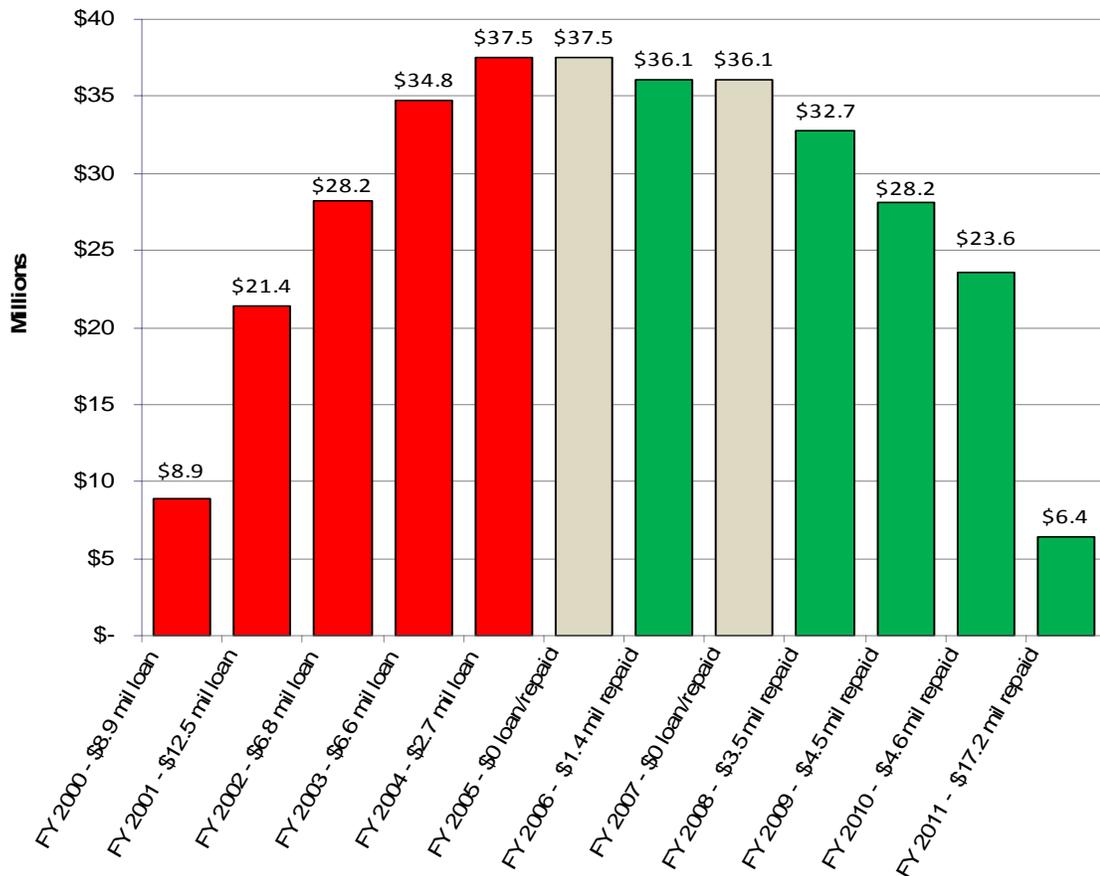
¹¹ Manager Loans could also be funded by MHLF. Assurance Agreement Section 4.2, Management Agreement Sections 5.1.1, and 5.1.2.2

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million at the end of fiscal year 2004 (see TABLE 2). In fiscal year 2006, BPL first started reducing the Manager Loan balance, by \$1.4 million. There were no reductions in fiscal year 2007. In the last four fiscal years, repayment of Manager Loan totaled \$29.7 million, as follows:

Fiscal Year 2008	\$3.5 million	Fiscal Year 2010	\$4.6 million
Fiscal Year 2009	\$4.5 million	Fiscal Year 2011	\$17.2 million

TABLE 2 Manager Loan Balance By Fiscal Year
Fiscal Years 2000 - 2011



Note(s):

- 1) Fiscal year 2000 represents only six months of operations, since the Arena opened on December 31, 1999.
- 2) Start-up operating costs were offset from fiscal year 2000 through fiscal year 2002 by a total of \$5 million worth of payments by the County to BPL between October 1998 through July 1999.

The Arena became “self supporting” in fiscal year 2005, in that Arena Revenues were large enough to cover Arena Operating Expenses and other

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allowable deductions. However, because of the need to pay down the Manager Loan balance, there has been no Net Cash Flow in any given fiscal year. As stated earlier, there has been no Net Cash Flow available to apply against the \$14 million profit share threshold, much less sufficient to result in a profit share for the County. As of the last reported fiscal year ended June 30, 2011, the Manager Loan balance is \$6,442,727, the Accrued Interest balance is \$144,983, and unpaid Management Fees are \$2,975,000. There are unpaid Management Fees because the Manager Loan balance must first be paid off before BPL can collect its Management Fee. Collectively, unpaid loans, accrued interest, and management fees currently total \$9,562,710.¹²

In summary, if outstanding balances remain for Manager Loans and Unpaid Management Fees after all current year's cash flows are depleted, the County will not be entitled to any monies pertaining to the profit share provision. Thus, in order for the County to receive any monies from the profit share provision for fiscal year ending 2012, which requires a Net Cash Flow of over \$14 million, this \$9.6 million balance, plus all interest and management fees accrued in the current fiscal year will first need to be paid from the current year's cash flow.

We note that had there not been the \$28.2 million outstanding Manager Loans, Unpaid Management Fees, and accrued interest in fiscal year 2011, Arena Net Cash Flow would have been sufficient to provide the County with about \$1.8 million under the Agreement's profit share provision. In fact, absent consideration of manager loans, etc., fiscal year 2011 would have been the first year that Arena operations generated Net Cash Flow greater than \$14 million triggering the 60-40 profit share provision.

VI. OIG JURISDICTIONAL AUTHORITY

In accordance with Section 2-1076 of the Code of Miami-Dade County, the Inspector General has the authority to make investigations of County affairs and the power to review past, present and proposed County and Public Health Trust programs, accounts, records, contracts, and transactions. The Inspector General has the power to analyze the need for, and the reasonableness of, proposed change orders. The Inspector General is authorized to conduct any reviews, audits, inspections, investigations, or analyses relating to departments, offices, boards, activities, programs, and agencies of the County and the Public Health Trust. The Inspector General shall have the power to review and investigate any citizen's complaints regarding County or Public Health Trust projects, programs,

¹² Derived from BPL's Schedules of Management Agreement Computations, as of June 30, 2011.

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contracts, or transactions. The Inspector General may exercise any of the powers contained in Section 2-1076, upon his or her own initiative. The Inspector General shall have the power to require reports from the Mayor, County Commissioners, County Manager, County agencies and instrumentalities, County officers and employees, and the Public Health Trust and its officers and employees, regarding any matter within the jurisdiction of the Inspector General.

VII. OBJECTIVES, SCOPE, AND METHODOLOGY

The OIG performed an audit of the terms and conditions of the Agreements executed between the County and BPL, and related parties, for the management of the Arena. Our audit took a two-fold approach in assessing the performance of both parties to the Agreements. On the County side, the OIG assessed the adequacy of the County process used to review and approve BPL's annual budgets submitted to the County. Our review also included ascertaining the nature of the relationship between the County and BPL, and educating ourselves on the history and evolution of the Agreements. This was generally accomplished through interviews and examination of the public records.

On the BPL side, our review generally focused on BPL's financial reporting and vendor utilization. Specific objectives included determining financial conditions related to Arena Distributable Net Cash Flow; assuring that expenditures were accurately and appropriately recorded; assuring that cost allocations¹³ were based on reasonable methodologies and consistently applied through the years; and providing a benchmark for future comparisons of year-over-year actual expenses and budget-to-actual expenses.

Our audit period was BPL fiscal years ending June 30, 2005 through June 30, 2010; although, when deemed necessary, we reviewed documents and interviewed both County and BPL personnel about activities both before and after these dates. Our audit also covered events and activities during the period beginning shortly before the execution of the Agreements in 1997 by Miami-Dade County, BPL, and MHLP. In addition, we examined later events, such as BPL's fiscal year 2012 Annual Operating Budget, as well as its audited Financial Statements and Schedules of Management Agreement Computations for fiscal year 2011.

¹³ Costs allocations include shared expenses for salaries and fringe benefits, and some miscellaneous items, such as photocopier expenses, etc.

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Miami-Dade County Fieldwork

We interviewed current and former County officials that were involved with the development and execution of the Agreements, as well as those involved with the ongoing administration of the Agreements through the current time.

In order to obtain a historical background of the evolution and execution of the Agreements for the development of the Arena (1996-1999), OIG members interviewed one former County mayor, two former County managers, a former assistant County manager, a former County budget director, and two current assistant County attorneys that held positions during this period. Records reviewed by the OIG involved all the various BCC approved resolutions and the resulting Agreements related to the development of the Arena.

Relating to the County's contract administration activities over the past 11 years (2000-2010), OIG Auditors requested to review practically every record in the County's possession relating to BPL's financial reporting requirements. This included reviewing all budgets submitted by BPL (2002 – 2011); all audited financial statements (1998 – 2011); and all Schedules of Management Agreement Computations¹⁴ (2000 – 2012).

Also, directly pertaining to contract administration and oversight, OIG members interviewed 10 County officials (former and current) who were identified¹⁵ as having some job-related task or responsibility related to the Management Agreement. We interviewed one former County manager, three former assistant County managers, two current assistant County attorneys, one former Finance Department director, one current Audit Management Services director, and one current director and one current executive assistant to the director from the ISD that held positions during this period.

¹⁴ BPL shall provide the County with a schedule setting forth the computation of Arena Revenue, Arena Operating Expenses, Arena Net Cash Flow, Arena Excess Net Cash Flow, Arena Distributable Net Cash Flow Payments, Arena Guaranteed Debt Service Payments, Management Fee Payments, Arena Capital Replacement Reserve Payments, and the division and distribution of Arena Distributable Net Cash Flow, taking into account that any amount in excess of \$14 million will be shared 60% to BPL and 40% to the County. (Management Agreement Section 5.11.2.1)

¹⁵ Some individuals were identified by the position(s) that they held or because their name appeared on a document or record. Other individuals were identified through interviews of other staff.

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BPL Fieldwork

Our audit included examining BPL's audited consolidated financial statements, trial balances and other accounting records (such as journal entries, payroll data, and a sample of BPL expenditure items and vendor payments), along with related support documentation. We tested BPL expenditures to determine whether they were accurately and completely recorded and appropriate to Arena operations, and tied personnel costs to related trial balance accounts for two fiscal years. We reviewed BPL's allocation methodology and tested some of its cost allocations to determine whether they were based on reasonable methodologies consistently applied through the years. We analyzed BPL's annual budgets and attempted to reconcile that information with the Schedules of Management Agreement Computations. This step also necessitated OIG auditors to assess BPL's process that it uses to prepare these schedules. Lastly, OIG auditors conducted interviews of key BPL personnel¹⁶ throughout the audit process to acquire an understanding of BPL's management and accounting practices.

Assertion of Trade Secrets Protection – OIG Impairment

Throughout the course of the OIG's review, BPL maintained that certain of its organization's records (including accounting records, journal entries, vendor utilization registers, invoices, general ledgers, trial balances, personnel salaries, and organizational charts) are "trade secrets" protected under Florida law and are thereby "confidential." BPL cited Section 22.22 of the Assurance Agreement¹⁷ as the authority for its position. The OIG disagreed with its blanket assertions.¹⁸

The OIG contends that this section does not preclude the County from reasonable access to records—trade secret or not—pursuant to the County's audit and inspection rights under the Management Agreement.¹⁹ However, in

¹⁶ For purposes of this report, we refer to "BPL" personnel to include individuals employed by BPL, as well as those individuals employed by the MHLP who perform services for and whose personnel costs are allocated to BPL.

¹⁷ The Assurance Agreement was entered into on April 29, 1997 by the County, MHLP and BPL.

¹⁸ Section 22.22 acknowledges that certain Manager records, which may have been examined or obtained by the County pursuant to a County review or audit of the Manager's performance, may be considered "trade secret information" pursuant to Florida law. Section 22.22, however, provides a protocol on how the County is to handle potential trade secret information and requires the County to notify the Manager of public record requests for said information in its possession. In the event that the County and the Manager disagree on the trade secret status of a record or records, both parties shall jointly seek a declaratory judgment with the Florida Circuit Court.

¹⁹ Section 5.11.3 of the Management Agreement

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consideration of our need to conclude the review, we agreed to certain recording limitations, as long as BPL afforded us full access to the requested records.²⁰

On some of the records that we received copies of, the copies were conspicuously stamped with a notice alerting the holder to the protocol of Section 22.22 of the Assurance Agreement.²¹ In other instances, we were allowed to inspect documents but were not provided with copies—stamped or not. On other occasions, we were prohibited from taking notes on the information contained in the documents, and on other occasions auditor field notes were subject to BPL’s review to ensure that we did not transcribe financial information that BPL contended was trade secret.

Specifically, as it related to BPL’s organizational structure and personnel compensation that were necessary components to our verification of the Schedules of Management Agreement Computations, the OIG was provided with full access to source documentation. We were supplied with a computer and software programs to perform our testing and analysis on-site. Our detailed work papers and the supporting documentation, however, are being maintained by BPL in its offices. These stored records are available for additional review, if deemed necessary. In addition, both OIG and BPL personnel signed and dated all of the analytical schedules that we prepared showing our audit results. For our summary work papers (belonging to the OIG), the OIG drafted summary memos that detailed the source documents that we reviewed, the procedures that we applied to complete our review, and our audit results. BPL was allowed to review our summary memos to assure themselves that financial information, (e.g. specific salaries, etc.) was not transcribed onto the work papers that we took with us.

While the OIG acknowledges that we were provided full access to the information requested, these arrangements, nevertheless, impaired our ability to record our observations and analysis unfettered. These arrangements also impaired our ability to publically report the amounts of certain questioned expenses.

Our audit was conducted in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States, which are incorporated by reference into the *Principles and Standards for Offices of Inspector General* promulgated by the Association of Inspectors General.

²⁰ The OIG’s agreement to these recording limitations should in no way be seen as our concurrence that the subject records are trade secrets. We agreed to this process in order to avoid potentially long and protracted litigation that would have likely resulted from our issuing a subpoena in the case.

²¹ The idea of conspicuously stamping documents was suggested by the OIG; and our suggestion was meant to apply to all the documentation for our review, but that was not to be the case.

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VIII. FINDINGS AND RECOMMENDATIONS

SECTION 1 BPL BUDGETS AND YEAR-END FINANCIAL REPORTING

This Section contains OIG observations related to the County's ability to review financial reports issued by BPL, along with the actual review practices followed by the County. Our first two findings address BPL reports that are to provide the County with financial information ranging from data used during the budget approval process to data reporting the related actual results. Our third finding addresses the lack of comparability among these financial reports. Following this third finding, recommendations are made to address the issues raised within this Section.

FINDING No. 1 The County has little understanding of the financial complexities related to BPL's Schedules of Management Agreement Computations, which is the key document showing whether there will be a 60-40 profit share.

BPL's Schedules of Management Agreement Computations is the financial report provided to the County detailing the various computations needed to restate BPL's financial results, according to its audited consolidated financial statements, as Arena Distributable Net Cash Flow (Net Cash Flow), which will show whether there will be the 60-40 profit share. Notwithstanding the importance of this document, however, the County has little understanding of the report's components and the significance of these components.

Based on anecdotal evidence derived during our interviews of County personnel, we learned that the recipients of these reports would look straight to the bottom line to see whether BPL's Arena Net Distributable Cash Flow reached the \$14 million threshold where profit sharing with the County would take place. Upon discovering that the County was not going to receive a profit share, the recipients would file this report away. It appears that the County considered its contract administration responsibilities satisfied by nothing more than a glance at the "bottom line" showing Net Cash Flow.

Given the Arena's importance, its financial performance, and its profit share potential over its first ten and one-half years of operation, we think that the County's approach has been inadequate. Through the 2011 fiscal year, the Arena has never had a positive Net Cash Flow, i.e., sufficient funds to allow BPL to receive any of the first \$14 million of Net Cash Flow, much less a Net Cash

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Flow over \$14 million that would be necessary to trigger the BPL/County 60-40 profit share.

The OIG interviewed BPL about its process used to prepare the Schedules of Management Agreement Computations. These schedules contain the calculations used to determine whether the County receives a share of any Arena profits. BPL's process is very much manual in nature; there is no automated system used to download and compile its accounting detail into the format reported via the Schedules of Management Agreement Computations.

BPL allowed us to review the supporting document used to create the fiscal year 2010 report, as provided in the Schedules of Management Agreement Computations. (Note, however, that BPL management precluded us from copying this document and certain supporting records for the audit work papers.)

Initially, BPL printed out a hardcopy of its fiscal year-end trial balance for 2010. BPL uses the trial balance to create a spreadsheet that compiles the amounts that it discloses in the Schedules of Management Agreement Computations. BPL creates this spreadsheet by first labeling each component on the hardcopy trial balance to a corresponding revenue or expense item that it reports on the Schedules of Management Agreement Computations. The spreadsheet also contains references related to Management Agreement terms in an attempt to ensure that every item stated in the Management Agreement is being addressed. These references assist in the reconciliation of all revenue and expense items listed on the trial balance to a corresponding component of the Schedules of Management Agreement Computations.

Once BPL staff compiles this spreadsheet, they submit it to BPL's Chief Financial Officer for approval. Upon his approval, BPL sends the spreadsheet to its certified public accountants, PricewaterhouseCoopers, LLP (PWC). PWC uses this information to create the Schedules of Management Agreement Computations that it issues, as a component of its fiscal year-end reporting accompanying BPL's audited financial statements.

Up until recently, the County made no effort to approach BPL about its financial records and reporting methodology. As a result, the County has not gained an understanding of the revenues, expenses, and capital items and amounts included in BPL's annual budgets and its Schedules of Management Agreement Computations, particularly as they pertain to the Agreement's profit share provision. Many of the issues described in our report evidence the County's lack of understanding. We believe that these issues should have been noticed by the County and remediated already.

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BPL Response to Finding No. 1

BPL agrees that there is a complex contractual relationship between it and the County that is governed by the Agreements but that this does not mean that the County has “little understanding.” BPL asserts that, “From the outset of the relationship, the County and BPL have conducted extensive discussions relating to Arena operations and finances. Specifically, BPL engaged a liaison whose role was to maintain direct and on-going communications with the County representatives on these issues.”

Additionally, BPL takes issue with the OIG’s use of the terms “profit” and “profit share” because they are “wrong and mischaracterizes the nature of the relationship.” BPL states that the use of these terms “could lead a reasonable person to evaluate BPL’s performance against an improper standard” because a reasonable personable may not believe that the terms “profit share” and “Arena Distributable Net Cash Flow” are interchangeable. BPL also points out that, like the County, it has yet to receive any distribution of Arena Distributable Net Cash Flow, as derived by the results of the Schedules of Management Agreement Computations that is prepared pursuant to the Management Agreement.

BPL concludes its comments on Finding No. 1 by stating that it and the County have been meeting to discuss the rights and obligations of the parties and to ensure that the parties have a clear, mutual understanding of the required calculations. In addition, BPL states that it and the County are in the process of developing protocols to streamline the aforementioned process.

OIG Rejoinder to BPL Response to Finding No. 1

The OIG reaffirms its finding. Our interviews of County personnel, including those designated as the County Representative, and review of County records clearly show that the County has little understanding about the financial complexities related to BPL’s Schedules of Management Agreement Computations. While BPL states that, since the inception of the Agreement, it has engaged a liaison to “maintain direct and on-ongoing communication with County representatives,” there is no evidence to support that this individual met with the designated County Representative about BPL’s Schedules of Management Agreement Computations or, for that matter, any of the other specific financial reporting issues that we address in this report. Moreover, regarding its engagement of a liaison, BPL did not maintain supporting documentation of this individual’s activities and communications on BPL’s behalf. Instead, BPL only maintained copies of this individual’s requests for payment of its monthly retainer, with no descriptive information regarding the details of services performed.

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The OIG also reaffirms its use of the terms “profit” and “profit share” in the same context that it also uses “Arena Distributable Net Cash Flow.” Our use of these terms does not reflect the OIG’s “lack of understanding of the complex nature of the relationship as provided for in the Agreements ...” Rather, it was our attempt to use more commonly known terms to describe that amount, which would be subject to distribution, as provided for in the Agreements. We note that in our report, we do go into detail about what comprises this “profit” using Management Agreement terms. For example, see TABLE 1 in this report’s Background section.

FINDING No. 2 The County’s budget review process has been inadequate.

The OIG found the County’s review process of BPL’s Annual Operating Budget to be inadequate, mostly because there has been no leadership by the County to establish a meaningful contract administration function. Two factors compounded this condition. One was that the contract administration function repeatedly moved from one County individual to another, therefore, no one ever had a real opportunity to take ownership of this function. The second factor was that there was no guidelines for staff to follow that prescribed the steps that needed to be taken to accomplish an effective review. As a result, we observed that the County, over the past ten plus years, has gained little understanding of the complexity of Arena operations or familiarity with the content and format of BPL’s submitted financial reports.

The OIG observed that various County personnel have taken turns as the designated “County Representative”²² responsible for overseeing Arena operations, as permitted by the Agreements. Regardless of the individual performing this function, we observed that the County’s process was cursory. While County personnel may have compared the current year’s submitted operating budget against the prior year’s operating budget, OIG auditors found no evidence that any meaningful analysis, such as a variance analysis, was performed.

As a result, the County did not have any cause to question BPL, by way of written notice, to explain its operating budget and the year-to-year changes. Accordingly, the County’s review process was inadequate and would not have provided reasonable assurance that the County exercised due diligence in “approving” BPL’s operating budget. In essence, by not responding in writing,

²² Management Agreement Section 20.17

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the County was deemed to have approved BPL's Annual Operating Budget, as submitted.

As noted above, BPL operating budgets are deemed approved if the County does not provide a written response to BPL within five business days from its submission.²³ BPL indicated to the OIG that it has not received written approval of its Annual Operating Budget from the County since the inception of the Arena. Furthermore, BPL stated that over this same time it has not received inquiries from County representatives pertaining to amounts presented on any of its Annual Operating Budgets provided to the County. We note that had the County performed reviews of BPL's operating budgets, we believe it would have had reason to question the budgets because they were not showing sufficient cash flow that would allow the profit share to occur. This showing, even without capital equipment and lease budgets, we believe should have caused the County to question BPL's proposed operating budget.

The following tables (see TABLE 3 and TABLE 4) contain a few examples prepared by the OIG of year-over-year comparisons for budgeted operating revenues and expenses that we think should have prompted inquiries of BPL by the County.

TABLE 3 Budget Variances—Revenues

Revenues by Account Name	Fiscal Years (FY)	Prior Year Budget	Subsequent Year Budget	Variance Amount	% Variance
Star Box Revenue	FY08 vs. FY09	\$3,500,000	\$850,000	(\$2,650,000)	(76%)
Courtside Lounge Revenue	FY10 vs. FY11	\$12,980,000	\$19,261,356	\$6,281,356	48%
Building Partners Revenue	FY10 vs. FY11	\$4,500,000	\$6,575,000	\$2,075,000	46%
Loges Revenue	FY09 vs. FY10	\$2,350,000	\$1,500,000	(\$850,000)	(36%)

Note: A positive variance amount denotes an increase in projected revenue from one fiscal year to the next.
Source: BPL Annual Operating Budgets

²³ Management Agreement Section 4.15.1 requires BPL to submit its Operating Budget to the County no later than 45 days prior to the commencement of a new fiscal year and gives the County five business days to respond in writing. An issue is that there is no method to measure "five business days" from date of submission because this date is an undefined variable (BPL transmittal letter date vs. County receipt date).

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TABLE 4 Budget Variances—Expenses

Expenses by Account Name	Fiscal Years (FY)	Prior Year Budget	Subsequent Year Budget	Variance Amount	% Variance
Public Relations – Fees	FY09 vs. FY10	\$0	\$125,000	\$125,000	100%
Legal Fees – Lobbyist	FY11 vs. FY12	\$120,000	\$294,000	\$174,000	145%
Legal Fees – Architect	FY11 vs. FY12	\$240,000	\$450,000	\$210,000	88%
Satellite/Cable Subscription Fees	FY11 vs. FY12	\$3,000	\$100,000	\$97,000	3233%
Advertising/Marketing and Sales Salaries	FY10 vs. FY11	\$1,166,580	\$1,532,352	\$365,772	31%
Advertising/Marketing and Sales Salaries	FY07 vs. Y'08	\$1,058,478	\$1,360,361	\$301,883	28%
Adv./Mktg. and Sales Contractual Bonus	FY08 vs. FY09	\$0	\$100,000	\$100,000	100%
Equipment Rental/Media Mesh	FY09 vs. FY10	\$6,000	\$684,295	\$678,295	11300%

Note: A positive variance amount denotes an increase in projected expense from one fiscal year to the next.
Source: BPL Annual Operating Budgets

We believe that had the County performed an adequate examination of BPL's Annual Operating Budgets, the above variances, as well as others, would have been noticed. Once noticed, these budget variances should have prompted some level of due diligence on the part of the County to research their causes and to obtain from BPL some reasonable assurances as to their nature, necessity, and amounts. However, this did not happen.

Regarding its review of BPL's Annual Capital Budget, the OIG found no evidence that the County had ever received one—let alone reviewed one. The lack of any correspondence, notations, or recollections by County personnel on the subject of reviewing a capital budget is surprising. One would think that over ten plus years, one of the individuals designated as the County Representative would have realized that the County was not receiving an Annual Capital Budget, as required by the Management Agreement terms, and would have asked BPL for a copy of one.

Moreover, because the County did not have BPL's Annual Capital Budgets, the County never reviewed or approved these budgets. On average, BPL's capital expenditures totaled about \$3.0 million per year. Additionally, BPL equipment lease expenditures were not shown in either its operating or capital

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budgets. On average, these lease expenditures totaled about \$2.3 million per year for fiscal years 2005 - 2010. In total, this \$5.3 million of average annual expenditures was never reviewed or approved by the County in a formal budget submission by BPL prior to the start of a new fiscal year.

Notwithstanding the other deficiencies of the County's budget review, the County effectively precluded itself from performing meaningful budget reviews because it did not take action when BPL did not timely submit its budgets. Even with timely submitted budgets, the County would have been challenged to complete a thorough budget analysis. The five-business day deadline is unreasonable and would not allow the County adequate time to complete a meaningful review regardless of when budgets were submitted.

BPL Response to Finding No. 2

BPL contends that there has been regular communications between it and the County regarding operations and finances over the past 12 years. BPL continues by stating that upon becoming aware that this issue was a concern to the OIG, it and the County began meeting to develop specific budget protocols.

OIG Rejoinder to BPL Response to Finding No. 2

The OIG reaffirms its finding that the County's budget review process has been inadequate. As specifically described in this finding and elsewhere throughout this report, the County has poorly administered this contract. We also reiterate that we found no record or anecdotal evidence of any regular communications between BPL and the County regarding Arena operations and finances. We are pleased that the parties are now finally getting together to discuss these issues.

FINDING No. 3 BPL financial report formats are not easily comparable, which limits the County's ability to obtain useful and relevant data.

Because of differences in format in BPL financial reports submitted to the County—annual budgets, audited financial statements, and its Schedules of Management Agreement Computations—the County could not have easily performed a comparison of these reports. (See OIG Schedule C for copies of BPL's fiscal year 2010: Operating Budget, Capital Budget, Audited Financial Statements, and Schedules of Management Agreement Computations.) The OIG found that comparing items and amounts between the various reports was impossible without first performing a very complex, time-intensive exercise to

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align comparable data into a unified presentation. Only after completing this process, could we complete our analysis of the data.

We acknowledge that BPL's beginning of the year annual budgets and its end of the year Schedules of Management Agreement Computations serve two different purposes. BPL budgets are the basis for County approval of projected revenues and expenditures, and by default, gave approval of BPL's proposed management of Arena operations during the upcoming fiscal year, whereas, BPL's Schedules of Management Agreement Computations presents the actual results of its management. Their two purposes, however, are inter-related. Without examining one in direct context of the other, the County cannot effectively understand Arena operations, as provided for pursuant to the Agreements. As such, the OIG strongly believes that these two reports should be more comparable.

For example, operating budget amounts net to "Earnings Before Interest, Depreciation, Taxes, and Amortization" (EBIDTA), whereas Schedules of Management Agreement Computations amounts net to "Arena Distributable Net Cash Flow" (Net Cash Flow). BPL operating budgets may show that the Arena is making a "profit" but they do not show whether there will be any Net Cash Flow for a 60-40 distribution at the end of the year. Moreover, without a Capital Budget (inclusive of equipment leases) the County is only partially informed of BPL's proposed expenditures for the year.

We acknowledge and are pleased that the County recently has made an effort to obtain additional financial data from BPL concerning Arena financial status. In late 2011, senior County officials told the OIG that the County would be taking a more active role in contract administration. In early 2012, we learned that the County had requested BPL to provide a line-by-line comparison of its operating budget EBIDTA to its audited consolidated financial statements EBIDTA for the corresponding period. Nevertheless, we believe that the requested comparison will have only limited use. This comparison is incomplete because it does not show all of the items that comprise BPL's Schedules of Management Agreement Computations. Items and amounts that will not be compared include BPL's capital equipment purchases and leases, Arena cost amortization, management fees, manager loans, and accrued interest.

The Management Agreement (Sections 4.15.1 and 4.16.1) empowers the County with the ability to request that BPL provide "additional detail [to both its Operating Budget and its Capital Budget] as the County may reasonably request." Therefore, we suggest that the County should also request that BPL prepare a pro forma Schedules of Management Agreement Computations, using the budget amounts, at the same time that it prepares its Arena annual budget.

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Collectively, these financial reports would provide a more complete presentation of BPL's projected management of Arena operations. In addition, as discussed later, there is a timing difference that precludes the County from being able to timely review BPL's next fiscal year budgets in comparison to the current fiscal year's actual results, prior to its review and approval of the next fiscal year's budget.

Report comparability is important because through the years, BPL's operating budgets have consistently shown a projected profit for Arena operations. However, in all of these same years, there has never been sufficient Net Cash Flow that would provide sufficient funds for the 60-40 profit distribution. Moreover, notwithstanding BPL's operating budget "profits," we note that during its first four and one-half years of operations, BPL Manager Loans totaled \$37.5 million, or about \$8.3 million per year. These loans were on top of the \$5 million already provided by the County to help offset Arena start-up operating costs.

In large part, this incomparability is because BPL's operating budget does not include all items and amounts that later show up in its Schedules of Management Agreement Computations, when calculating Net Cash Flow. For example, there has been the missing Capital Budget showing projected expenditures on Arena property and equipment. For fiscal years 2005 – 2010, BPL's budgeted property and equipment expenditures ranged from \$817,565 to \$4,000,000. In addition, BPL does not include in either of its budgets, its projected equipment lease costs. For the same period, BPL's annual actual lease cost expenditures ranged from \$1,018,479 to \$3,861,160. BPL, as well, is allowed to deduct "Arena Cost Amortization" from Net Cash Flow, pursuant to the Agreements. The annual actual amounts of Arena Cost Amortization for the cited period ranged from \$14,181,322 to \$14,539,530.

The Agreements impose no specific requirement on BPL to make comparable its financial reporting. In addition, the Agreements leave open to BPL's discretion how it would present its annual budgets to the County, although, as noted, the Agreements also give the County rights to request "additional detail." But as we pointed out, in total, items not included in either budget (including the not submitted Capital Budget), such as equipment leases and Arena cost amortization, totaled anywhere from about \$15 to over \$20 million per year in deductions to Arena revenues. In addition, manager loans, management fees, and accrued interest—that added tens of millions more to Arena revenue deductions—were not reported in any budget.

As noted, prior to the OIG's audit, the County made no apparent effort to request such additional detail from BPL. It would have been evident from the onset that, without additional detail, there were significant reporting issues that

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would preclude the County from being able to understand BPL's Arena operations, as well as to gauge whether there may be sufficient funds left over to trigger the 60-40 profit distribution. A simple visual comparison of a BPL annual operating budget to its subsequent corresponding Schedules of Management Agreement Computations would have shown just how incomplete a picture of Arena operations that BPL presented in its operating budget.

Lastly, we note that the timing of the issuance of BPL's annual budgets versus the submission of its audited consolidated financial statements makes it impossible to timely reconcile variances between actual and projected budget amounts. Budgets are due no less than 45 days before the start of a new fiscal year (July 1), whereas audited consolidated financial statements for the period covered by the prior year's budget are not required to be submitted until 120 days after the end of the fiscal year, or around October 31. Because of this timing difference, the County would have no way of evaluating a current year's budget in light of the prior year's results.

BPL Response to Finding No. 3

BPL states that its financial reports were prepared pursuant to the Management Agreement and that its independent certified public accounting firm "issued a letter each year regarding compliance with the terms of the Management Agreement and there has never been a finding of noncompliance."

BPL acknowledges that early audit discussions with the OIG on this very topic resulted in BPL approaching the County on financial reporting processes. In addition, BPL states "it will provide estimates of the Schedules of Management Agreement Computations in order to forecast how the calculations will look at the end of the year."

OIG Rejoinder to BPL Response to Finding No. 3

The OIG reaffirms our finding and stresses the need for both parties to communicate openly and regularly about the information contained in BPL's financial reports.

OIG Recommendations for Section 1 (Recommendations Nos. 1- 8)

1. The County should become familiar with the accounting details and reporting methodology underlying BPL's budgets and its Schedules of Management Agreement Computations and how they relate to the definitions for Arena Revenue and Arena Operating Expenses listed in the Management Agreement.

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2. The County should create written procedures that detail a review process to be followed for each financial report provided by BPL. These procedures should include an explanation as to why the report needs to be reviewed, along with the steps necessary to complete the review.
3. The County should require BPL to submit its annual operating and capital budgets to the designated County Representative via email or hand delivery. BPL should also obtain a receipt of delivery to maintain for its records.
4. The County should require BPL to include its leased equipment expenses in its operating/capital budgets.
5. The County's process to review BPL's annual budgets should encompass formal steps, such as:
 - Comparing the current year's proposed budget detail to prior years' approved budget detail to determine whether there are variances and, if necessary, obtain additional data from BPL to determine the cause of and justification for the variances.
 - Requesting, as "additional detail," that BPL to submit a pro forma Schedules of Management Agreement Computations with its annual budget submissions using the amounts taken from the submissions to project whether BPL expects to reach the Net Cash Flow level necessary to share profits with the County.
 - Visiting BPL to review its financial records and interview BPL about its budget preparation process and proposed budget amounts.
6. As providing a written response within the five-business day deadline seems unreasonable, the County should negotiate a longer period. In addition, the County should obtain BPL's agreement on what constitutes the start date, (i.e. budget submission date) for measuring the duration of the County's review period.
7. The County needs to periodically review BPL trial balances, vendor payment reports, and source documentation (such as invoices, receipts, and contracts) to gain an understanding of specific expenses being incurred for Arena operations.
8. The County should request that BPL provide interim period (unaudited) financial statements showing its actual revenues and costs through a

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stated date (e.g., through the first 3 quarters of the fiscal year) and the projected revenues and costs for the remainder of the year, along with the coming year's budgets.

ISD Responses to Recommendation Nos. 1 - 8

1. This Administration has engaged BPL in multiple discussions related to the existing agreements. Once the upcoming year's budgets have been received, the County will meet with BPL staff to request documents needed to have a clear understanding of the projections for the upcoming year.
2. The County will establish protocols for review of all documentation submitted by BPL to include recurring meetings with BPL throughout the year. Documentation will be retained to support the results of those reviews.
3. The County will notice BPL of the individuals who will be receiving the budgets and will request that the budgets be sent to them via e-mail with the originals hand delivered.
4. The County will ask BPL to include a list of its leased systems, equipment and furnishings as part of their Annual Operating and Capital Budget submittal and include the relationship of the lessor to BPL and its affiliated parties.
5. The County's budget review process for the Arena will include a comparison of previous year's budgets, Audited Financial Statements, and the Schedules of Management Agreement Computations and other trend analysis as needed. When warranted and based on the review, additional details will be requested of BPL in order to fully understand the budget submittal. The County will be meeting with BPL in the coming days to discuss aspects of next year's proposed budget.
6. BPL has agreed to provide the County with additional time in order to allow for a thorough review of the budget submittals. This additional time will give us the opportunity to meet with BPL as well as to request additional details as needed for our review.
7. Gaining an understanding of specific operating and capital expenses being incurred for Arena operations will be mainly accomplished through recurring meetings and communications with BPL as well as our review of the financial reports and computations submitted by BPL. We do reserve

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the right to specifically audit source documentation when questions arise. Additionally, we will continue to rely upon the independent external audit and the compliance report as to adherence by BPL of the terms of the management agreement, as amended, annually conducted by PricewaterhouseCoopers, LLP.

8. The County will discuss this matter with BPL. However, once the new protocols are implemented we will be able to better gauge the overall operations of the Arena. Our annual review of the budgets will include the necessary information to be able to determine if revenue sharing goals are expected to be met.

BPL Responses to Recommendation Nos. 1 - 8

1. BPL has proposed to the County that the parties work together to further develop the lines of communication, including the estimates of the Schedules of Management Agreement Computations referred to in BPL's response to Finding Number 3 above.
2. BPL has noted the OIG's observations regarding the review process and has been working together with the County for several months to define and develop procedures. To the extent that as part of the County's review process it determines that written procedures are in order, BPL has agreed to cooperate and work in good faith with the County.
3. BPL has proposed to the County that in the future, Operating Budgets and Capital Budgets will be transmitted via email or hand-delivery as opposed to the presently utilized methods of Federal Express or U.S. Mail. In all cases, an appropriate receipt will be obtained.
4. BPL has proposed to the County a modification to the Capital Budget format to include the capital leases.
5. BPL has made various other proposals to further advance the review process of financial data, including:
 - BPL has proposed to the County that the annual Operating Budget will be submitted by July 15th with comparisons to the prior year's approved budget, along with "draft" actual results for the previous fiscal year.

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- BPL has proposed to the County that it will submit a pro forma Schedule of Management Agreement Computations by July 15th of each year.
 - BPL has proposed to the County that during the budget process it will make itself available to answer any and all questions.
6. BPL and the County have discussed an extension for the 2012-2013 FY budget review process and have agreed to negotiate an amendment to the Agreements to extend the five-business day deadline and clarify what constitutes the start date.
7. BPL has proposed to the County a modification of the review process of BPL's expenses incurred for Arena operations. Specifically, as part of the enhanced budgeting and reporting processes noted above, BPL has proposed a quarterly meeting with the County. During these meetings, any questions the County may have regarding these expenses will be discussed.
8. On its face this recommendation does not take into account the nature of this business and the relevant timelines associated therewith and, as a result, suggests a protocol that is not practical.

OIG Rejoinder to ISD & BPL Responses to Recommendation Nos. 1 - 8

The OIG supports the actions proposed by both the County and BPL and is encouraged by their respective pledges to better cooperate and communicate.

While the County notes that it will “continue to rely upon the independent external audit and the compliance reports as adherence by BPL” to the terms of the Management Agreement, these reports should not take the place of the County performing its own due diligence of Arena finances and exercising its own contractual rights under the Agreements. As this OIG audit demonstrates, the scope and objectives of auditing the contract greatly differ depending on the purpose of the audit (e.g., a performance audit versus a financial statements audit). Reliance alone on any audit is not enough. We encourage the County to take a more proactive role in its contract administration function, thereby minimizing the need for future performance audits.

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SECTION 2 MANAGEMENT AGREEMENT TERMS

This Section contains OIG observations related to noncompliances on the part of the County or BPL, or both, with various terms and conditions of the Management Agreement. Each of our findings begins with a specific citation from the Management Agreement. The citation is followed by a brief discussion of why we believe the cited noncompliance merits inclusion in our report. Each finding ends with a recommendation(s) that the named party(ies) comply with the cited requirement.

There is one overarching provision of the Management Agreement that has not been adhered to. Non-compliance with this simple requirement, we believe, became the cause of many of the findings identified through the audit.

Section 20.23	Commencing with the Operations Start Date, the Manager shall consult regularly with the County Representative in order to keep the County reasonably informed as to the management and operation of the Arena. (Emphasis added by OIG.)
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The OIG observed that BPL has not been consulting regularly with the County. Of equal concern, the OIG observed that the County has not approached BPL to discuss its management and operation of the Arena. Whether in the Agreements or not, the importance of both parties communicating and cooperating about Arena management and operations is self-evident. It is inexplicable why the County did not make a greater effort to reach out to BPL, and BPL to the County, about how this valuable asset could best be managed and operated as a first-class facility. Since the inception of our audit, we note that the County has become more proactive in its contract administration of Arena operations, as permitted under the Agreements.

FINDING No. 4 BPL has not been providing an annual operating budget to the County at least 45 days prior to the start of a new fiscal year.

Section 4.15.1	Not less than 30 days prior to the date the Manager is required to submit to the Lender a proposed operating budget for the Fiscal Year of the Arena ending on the first June 30 following the Operations Start Date (which Fiscal Year may be less than 12 months) and for each Fiscal Year thereafter, but <u>in no event later than 45 days prior to the commencement of each Fiscal Year</u> during the term after the first Fiscal Year of the term, the Manager shall submit its proposed operating budget for such Fiscal Year (i.e., its projection of Arena Operating Expenses and Arena Revenues for such Fiscal Year) to the County Representative on such forms, in such format, with such content and with such detail as the Lender (or if there is no Lender, the County) may require, and with such additional detail as the County may reasonably request. The County Representative shall have five Business Days to approve the proposed
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	operating budget, which approval shall not be unreasonably withheld, or provide the Manager with written comments and requested changes. The failure of the County Representative to respond in writing within the five Business Days shall be deemed to be approval. (OIG emphasis)
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The OIG examined BPL's cover letters to the County transmitting its Operating Budgets. We observed that in eight out the eleven fiscal years between 2002 – 2012, BPL submitted its Annual Operating Budget to the County after the July 1st start date of the new year. For these fiscal years, BPL sent its operating budgets anywhere from 15 to 76 days late or, on average, 46 days late (less than 45 days prior to the commencement of the new fiscal year). BPL's performance has worsened in recent years. For the five fiscal years 2008 – 2012, BPL's Operating Budgets were late anywhere from 54 to 74 days or, on average, 67 days.

OIG Recommendation No. 9

9. BPL should take whatever steps are necessary to produce its Annual Operating Budget and submit it to the County within the timeframe required by the Management Agreement.

ISD Response to Recommendation No. 9

The County has discussed this matter with BPL and expects submittals of the Annual Operating Budget in accordance with the agreements.

BPL Response to Recommendation No. 9

BPL has provided the Operating Budget to the County annually since the inception of the Management Agreement. However, the time lines to produce the Operating Budget are not practical in light of the schedule, including post-season, of the Arena's largest tenant, the Miami HEAT.

BPL agrees that providing the County with meaningful budget numbers is important and therefore has proposed to amend the Agreement to July 15th , to coincide with the County's annual budgeting process.

OIG Rejoinder to ISD and BPL Responses to Recommendation No. 9

We hope the parties will be able to negotiate a reasonable solution.

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FINDING No. 5 BPL has not been providing an Annual Capital Budget to the County.

Section 4.16.1	Not less than 30 days prior to the date the Manager is required to submit to the Lender a proposed capital budget for the second full Fiscal Year of the Arena after the Operations Start Date and for each Fiscal Year thereafter, but in no event later than 45 days prior to the commencement of each Fiscal Year during the term after the first Fiscal Year of the term, the Manager shall submit its proposed capital budget for such Fiscal Year to the County Representative on such forms, in such format, with such content and with such detail as the Lender (or if there is no Lender, the County) may require and with such additional detail as the County may reasonably request. The County Representative shall have five Business Days to approve the proposed capital budget, which approval shall not be unreasonably withheld, or provide the Manager with written comments and requested changes. The failure of the County Representative to respond in writing within the five Business Days shall be deemed to be approved.
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During our examination of County files, we found no BPL Annual Capital Budgets or transmittal letters evidencing its submission. County personnel interviewed about the County’s annual budget review process were at a loss to explain the absence of the capital budget. The OIG notes that for over ten years, the County has not noticed this rather significant oversight on its part.

BPL explained to the OIG that it has submitted an Annual Capital Budget to the County every year, but when we asked BPL to provide us with copies of these budgets and accompanying transmittal letters, or receipts signed by the County acknowledging its acceptance of the budgets, BPL could only provide copies of the budgets. We find this irregular, because in all other instances—annual operating budgets, audited consolidated financial statements, and Schedules of Management Agreement Computations—BPL was able to provide complete sets of the submitted reports and accompanying transmittal letters.

The OIG observed that BPL made almost \$32 million of capital expenditures and equipment lease payments during fiscal years 2005 – 2010. This made capital expenditures and lease payments a major operating cost. BPL’s average annual capital expenditures, over the six-year period, totaled about \$3.0 million and its average annual equipment lease payments totaled about \$2.3 million. The County’s not having a capital budget to review impaired its understanding of BPL’s projected management of Arena operations. Furthermore, we note that BPL did not report its lease payment budget in either its operating or capital budget.

We also note that since Arena operations began, BPL’s practice has been to budget larger capital expenditures than required under the Agreements. When implemented, the expenditures have served to reduce available Net Cash Flow

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more than otherwise would have occurred and have lessened the County's opportunity to obtain a share of Arena profits. During these years, BPL chose not to fund an "Arena Capital Replacement Reserve Account" (Management Agreement Section 5.5). Had BPL done so, the reserve amounts would have been \$10.6 million less than the amounts shown in its capital budgets (\$5.8 million capital reserve vs. \$16.4 million capital budget).²⁴

Moreover, as it turned out, BPL's actual capital expenditures during the cited audit period totaled over \$17.9 million, or about \$1.5 million (net over six fiscal years 2005 – 2010) more than shown in its capital budgets, and about \$12.1 million more than otherwise required by the Agreements (see TABLE 5 next page). As noted, this trend began during the Arena's earlier years of operations. For example, BPL spent almost \$6 million on actual capital expenditures in fiscal year 2001—the first full year of Arena operations—even though there was no reserve requirement at that time and even though the Arena was a brand new facility.

We also note that the Management Agreement²⁵ states, in part:

... In addition, Arena Operating Expenses shall not include ... (iii) costs of Arena capital improvements, except to the extent reflected in the Lender Approved Capital Budget, required by the Lender pursuant to the instruments evidencing the Arena Debt, required by the Consulting Engineer or otherwise approved by the County pursuant to Section 5.5 and funded from sources other than the Arena Capital Replacement Reserve Account ...

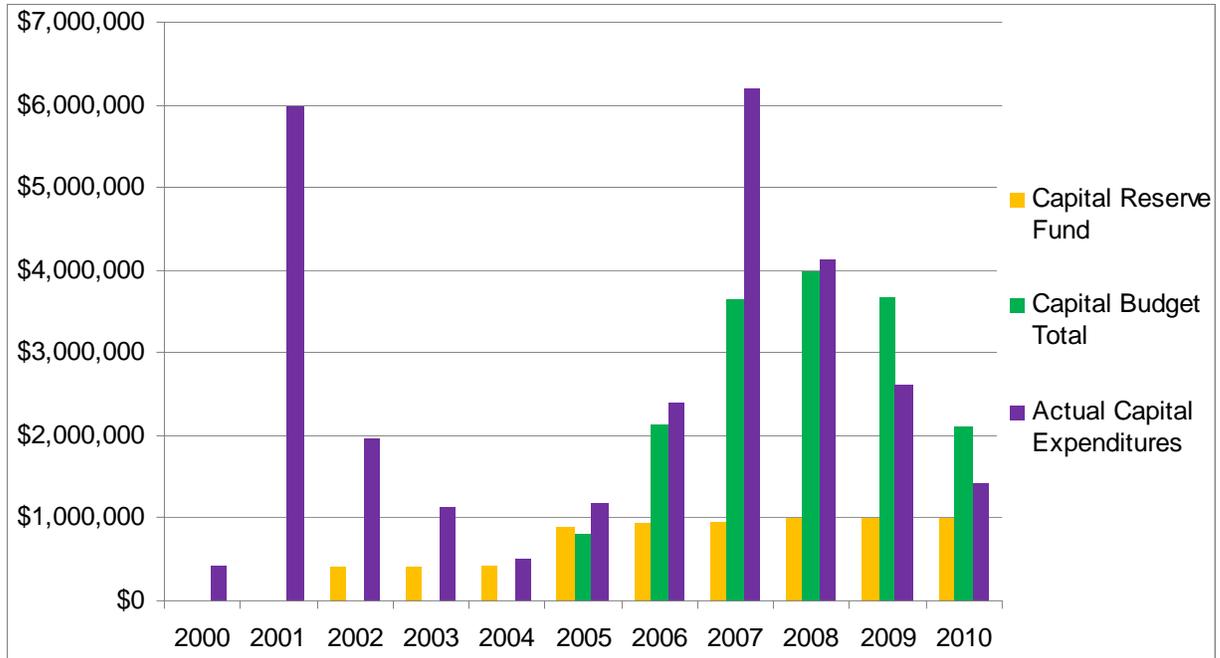
In other words, capital expenditures in excess of those shown in the budget are excluded from Arena Operating Expenses unless approved by the County. Given that the County has never received a capital budget, it surely cannot be deemed to have approved one.

²⁴ As noted earlier, these budgets were not in County files. The OIG obtained them from BPL during our audit.

²⁵ Management Agreement, Exhibit 1, Definitions 45, Arena Operating Expenses

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TABLE 5 BPL Capital Budget vs. Arena Capital Replacement Reserve vs. Actual Capital Expenditures



Notes:

- 1) Arena Capital Reserve payments were not due until the second full fiscal year after the Arena operations start date.
- 2) The OIG did not request a BPL Capital Budget for fiscal years outside of our audit period (2000 – 2004).
- 3) The Capital Budget Total includes budget detail for building operations, equipment, parking operations, security, F&B, concessions, general operations, IT, and AV.
- 4) We derived the amounts for Arena Capital Replacement Reserve and Actual Capital Expenditures from BPL's Schedules of Management Agreement Computations.

During our audit period, BPL spent anywhere from \$127,640 (fiscal year 2008) to \$2,549,810 (fiscal year 2007) more on capital expenditures than shown in its annual capital budget. During our six-fiscal year audit period, BPL spent more than its capital budget on four occasions (fiscal years 2005, 2006, 2007 and 2008), totaling \$3.3 million. Even if the County had approved BPL's capital budgets during the cited years, these excess expenditures would not have been allowable Arena Operating Expenses, pursuant to the Management Agreement.

BPL Response to Finding No. 5

BPL responds that it prepared its Capital Budgets in accordance with the Agreements. BPL also notes that all capital expenditures were disclosed at the end of every fiscal year in both the PWC audited financial statements, as well as

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the audited Schedule of Management Agreement Computations, and, as such, the County was aware of the capital expenditures.

OIG Rejoinder to BPL's Response to Finding No. 5

BPL's response, markedly, does not refute that a Capital Budget was not submitted to the County. Its response also misstates the OIG's concern—that the County was not provided with BPL's Capital Budget as required by the terms of the Management Agreement. As such, the County was never afforded the opportunity to review and approve BPL's capital budget, let alone approve expenditures in excess of the approved budget and paid with funds outside of the Arena Capital Replacement Reserve Account. Moreover, BPL's statement that it reported its capital expenditure amounts to the County in the PWC audited financial statements and in the Schedule of Management Agreement Computations falls short. These year-end reports only inform the County about the total amount spent on capital purchases. They do not reveal what was purchased and for how much. Most importantly, these year-end reports provide no comparison to a budgeted amount even if the County had actually received a budget.

OIG Recommendations Nos. 10 - 13

10. The County should ensure that prospectively, it receives from BPL its Annual Capital Budget, inclusive of equipment leases, within the timeframe required by the Management Agreement.
11. The County should seek to claim these amounts from BPL, via an adjustment to a future Schedules of Management Agreement Computations, BPL capital expenditures in excess of its capital budget, totaling \$3.3 million over fiscal years 2005 - 2010.
12. The County should review BPL's fiscal year 2011 results to determine if BPL's actual capital expenditures exceeded its capital budget and, if a similar over expenditure is found to have occurred, the County should seek recoupment.
13. The County and BPL should agree to a protocol to follow that would ensure that the County receives timely notice of BPL capital expenditures in excess of its approved capital budget amount.

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ISD Responses to Recommendation Nos. 10 - 13

10. The County has discussed this matter with BPL and expects submittals of the Annual Capital Budget in accordance with the agreements which will include a list of equipment leases.
11. The agreements set forth a process for approval of the capital budgets. This process includes a presumption of reasonableness, as described in section 5.11.3.3 of the Management Agreement, for expenses that meet certain standards inclusive of those expenses that exceed the Annual Capital Budget. The County will review the expenses incurred during this period and will work with BPL to understand the needs and impacts of each expense (e.g. were they necessary to maintain a first-class facility or were they incurred to increase revenues, something the County would look favorably upon). We will determine whether the expenses are presumed reasonable and customary pursuant to the provisions of the agreement while consulting with the County Attorney's Office as needed. It should also be noted that any disagreements between the County and BPL, with respect to this issue, are subject to mediation/arbitration.
12. Please see response to OIG Recommendations for Section 2 - Recommendation # 11 above.
13. The County will work with BPL to establish protocols to ensure timely notice of BPL capital expenditures in excess of its approved capital budget amount.

BPL Responses to Recommendation Nos. 10 - 13

10. As previously indicated, BPL has proposed to the County a revised timeline for submitting budgets and prospectively, the Capital Budgets will be inclusive of equipment leases.
11. BPL asserts that the OIG is wrong with regards to the assertion that all expenditures in excess of the Capital Budget are subject to recoupment is false and does reflect the standard in the Agreements. Specifically, BPL states that the Management Agreement provides that: "[E]xpenditures shall be deemed reasonable if the amount and type of expenditures are customary in accordance with industry standards in connection with maintaining, managing and operating an arena in a first class manner." (Section 5.11.3.3) BPL also states that it has provided the relevant contractual standard of review to the County and will provide the County with supporting documentation substantiating its position.

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12. BPL and the County will address the 2011 budget in accordance with the revised protocols and procedures.
13. BPL has proposed to the County to include a discussion of the capital expenditures as part of its planned quarterly meetings. This proposed enhancement in conjunction with the on-going liaison function shall ensure timely submission and notice of BPL capital expenditures in excess of its approved Capital Budget amount.

OIG Rejoinder to ISD and BPL Responses to Recommendations Nos. 10 - 13

Strikingly, both the County's and BPL's responses cite Section 5.11.3.3 of the Management Agreement for the proposition that expenditures are reasonable if they are customary in accordance with industry standards in connection with maintaining, managing, and operating an arena in a first class manner.²⁶ Both responses, however, ignore the express exclusions of what may constitute an Arena Operating Expense. Simply put, capital expenditures that are not approved by the County and are funded from sources other than the Arena Capital Replacement Reserve Account are not counted as Arena Operating Expenses.

Let us not forget that BPL never made annual contributions to the Arena Capital Replacement Reserve Account, as required under Section 5.1.3. The annual payment amount (determined by a formula provided in the Agreement) would have been automatically deducted against the Net Cash Flow (after payment of operating expenses and then the Arena Cost Amortization Payment). Thus, capital expenditures that are not approved by the County but are paid for through the Capital Replacement Reserve Account are already accounted for vis-à-vis the Net Cash Flow computation. In reality, however, because there was no Capital Replacement Reserve Account, BPL funded its capital expenses on a pay-as-you-go basis. These expenses would have required County approval, if BPL wanted to deduct them from the Arena operating expenses. BPL did, in fact,

²⁶ The context of what is reasonable pursuant to Section 5.11.3.3 is best found in the preceding sections. Section 5.11.3.1 discusses variances between the Lender Approved Operating Budget and the County Approved Operating Budget. Section 5.11.3.2 discusses variances between the Lender Approved Capital Budget and the County Approved Capital Budget. Variances of a certain amount are deemed reasonable. Section 5.11.3.3 (the section cited by both the County and BPL) begins with a statement about "Expenditures in excess of the higher of a County or Lender approved budget are subject to the County's challenge as unreasonable ..." The OIG's contention of why these amounts are questioned has nothing to do with reasonableness and all to do with the definition of what is an Arena Operating Expense.

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deduct them, but it never got County approval, either for its initial annual budget—which it failed to submit—or as expenditures in excess of the budget.

Both the County and BPL wish to couch this analysis as one of reasonableness. The County will seemingly retroactively approve those expenses presumed to be reasonable. The OIG’s finding is premised on the fact that these expenses were not approved, and because they were not paid for out of an Arena Capital Replacement Reserve Account, they cannot be deducted as Arena Operating Expenses impacting available Net Cash Flow. Lastly, the OIG could have questioned all expended amounts for capital improvements exceeding the amount that BPL should have funded the Arena Capital Replacement Reserve. We did not. Instead, as a conservative approach toward questioning costs, we only questioned those amounts that BPL deducted in excess of its undisclosed, internal capital budget. The OIG affirms its finding.

FINDING No. 6 The County has not requested that BPL provide an Arena personal property and equipment inventory listing, and BPL has not maintained copies of prior years’ listings.

Section 3.1.3	On or prior to the Operations Start Date, the Manager shall prepare a detailed inventory of all personal property and equipment in the Arena with a cost of in excess of \$750 (the “Inventory”) and deliver a copy of the Inventory to the County. The Inventory shall be maintained and updated (annually) throughout the term, and copies of the updated Inventory shall be provided to the County upon the County’s request.
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OIG Auditors did not find any personal property and equipment inventory listing in the County files that we reviewed. Moreover, the County apparently was unaware of the availability of such listings and of its right to request them from BPL. When questioned, BPL asserted that it provided the County with an initial inventory listing at the inception of operations and that in later years the County never requested one.

We requested from BPL that it provide us with its inventory listing as of the end of the fiscal year 2010. It was clear that BPL had not maintained this inventory but, nonetheless, prepared one for us dated as of June 30, 2010. BPL’s listing showed Arena personal property and equipment totaling \$5.1 million, which matched the amount disclosed in its audited consolidated financial statements for the year. Later, when we asked BPL to provide us with copies of previous listings prior to fiscal year 2010, BPL responded that it did not maintain hard copies of prior inventory listings and, because its accounting system “overwrote” older data with newer data, it could not generate copies of these older records.

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Annual changes to this inventory are important because they represent expenditures that will directly affect the County's ability to participate in the profit share provision. Property and equipment expenditures are operating costs that offset Arena revenues. As a result, they lower the Net Cash Flow that is available for the 60-40 profit share distribution.

BPL's average personal property and equipment purchases over the past ten fiscal years (2001 – 2010) totaled about \$2.8 million annually. We note that this roughly equates to annual expenditures that are \$2.1 million in excess of the average annual required funding (about \$708,000) that was to be deposited into the "Arena Capital Reserve Account" pursuant to Management Agreement Section 5.1.3. Notwithstanding this section's provision, in lieu of making a Capital Reserve Account deposit, BPL elected to fund capital expenditures on an as-needed basis each year, effectively increasing expenditures over the "required" amount.

In total, over the ten-year period, BPL spent about \$27.5 million on Arena personal property and equipment. About \$7.1 million was required funding; about \$20.4 million was spending in excess of the reserve requirement. Importantly, BPL made all of these expenditures without County review or approval.

OIG Recommendation No. 14

14. The County should request from BPL that it provide a personal property and equipment inventory listing as of the end of the most recent fiscal year, and require that every year hereafter that BPL automatically provide such a listing to the County, as part of its required fiscal year end reporting.

ISD Response to Recommendation No. 14

Annually, the County will review the personal property and equipment inventory list provided by BPL, as part of the budgetary review process.

BPL Response to Recommendation No. 14

While BPL has a differing view as to the requirements under Section 3.1.3, BPL has always maintained an updated Arena personal property and equipment inventory listing. BPL has proposed to the County to amend the Agreement to

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provide the Arena personal property and equipment inventory listing in October along with the audited financial statements.

OIG Rejoinder to ISD and BPL Responses to Recommendation No. 14

The OIG notes that the County refers to the budget review process at the beginning of a year, while BPL refers to an end-of-the year process accompanying its release of its financial statements. The parties should meet to discuss a solution.

FINDING No. 7 BPL has not been submitting its annual leases of systems, equipment, and furnishings for County review and approval.

Section 3.1.1	The Manager may elect to lease, or lease purchase any of the systems, equipment and furnishings comprising the Arena which are customarily leased by the operators of similar arenas, including, without limitation, the score board, telecommunications system, video display boards, sound distribution system and television production facilities and concession, restaurant and related Arena furniture, fixtures and equipment, <u>subject to the prior written consent of the County Representative</u> , which consent shall not be unreasonably withheld; provided that the County Representative shall not withhold its consent if (a) the equipment proposed to be leased is customarily leased by operators of similar arenas, and (b) (i) in the case of leases to be entered into prior to the Operations Start Date, the lease is consistent with the Arena Budget, or (ii) in the case of leases to be entered into on or subsequent to the Operations Start Date, the economic terms of the lease are reflected in either a Lender Approved Operating Budget or a Lender Approved Capital Budget or, if none, a <u>County approved budget</u> (subject, however, to the County's audit and challenge rights with respect to the lease under Section 5.11). Any request for consent shall be accompanied by a term sheet for the proposed lease(s) containing all major economic and business terms of the proposed lease (s). Consent shall be granted or denied within three Business Days of the written request for such consent. The failure of the County Representative to respond in writing within the three Business Days shall be deemed to be consent provided the County has been given all relevant information in the term sheet. (OIG emphasis)
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We observed that BPL did not include budgeted lease costs in either its operating budget or its capital budget, let alone seek County approval for its leases. BPL's actual lease costs have averaged \$2.3 million annually, which makes them a major expense that should have been disclosed to the County for its review and approval, as part of the County's review and approval of BPL's budgets. BPL equipment leases were for visual display and security equipment, such as LED screens, projectors, cameras, monitors, etc.

The OIG also notes that BPL leases equipment from a BPL-affiliated entity. This is not to suggest that there is anything irregular with this lease arrangement merely because it is a related-party transaction, only that the

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County should be aware of these arrangements and have knowledge of main lease terms.

OIG Recommendations No. 15 - 16

15. The County should request that BPL provide a separate budget for its annual leases of systems, equipment, and furnishings, as part of its required budget submission process or include it in either its annual operating or capital budgets.
16. The County should require BPL to disclose the main terms of all of its equipment leases, including the relationship of the lessor to BPL and its affiliated parties.

ISD Responses to Recommendation Nos. 15 - 16

15. Please see response to OIG Recommendations for Section 1 - Recommendation # 4 above.
16. The County will ask BPL to include a list of its leased systems, equipment and furnishings as part of their budget submittal and include the relationship of the lessor to BPL and its affiliated parties.

BPL Responses to Recommendations Nos. 15 - 16

15. BPL has proposed to the County to amend the Agreement to provide for the additional inclusion of the annual leases of systems, equipment and furnishing in October along with the audited financial statements.
16. BPL has proposed to the County to amend the Agreement to provide for the additional inclusion of a report along with the audited financial statements summarizing the outstanding list of equipment leases and all their terms and conditions.

OIG Rejoinder to ISD and BPL Responses to Recommendation Nos. 15 - 16

The OIG notes that the County refers to the budget review process at the beginning of a year, while BPL refers to an end-of-the year process accompanying its release of its financial statements. The parties should meet to discuss a solution.

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FINDING No. 8 **The County has not requested the joint selection of an independent qualified engineer to inspect the Arena and provide a written report of the inspection to the County and BPL.**

Section 4.2.7	At the County's option, from time to time, the Manager and the County shall jointly select an independent qualified engineer experienced in arena operations (the "Consulting Engineer") to inspect the Arena and the Site to determine whether it is in good condition and working order and whether there are any items of deferred maintenance with respect to all or any portion of the Arena and the Site.
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The Arena is a multi-million dollar state-of-the-art facility that demands the County's attention to ensure that BPL is maintaining this County-owned facility as required and that its expenditures are well spent. This step should not be an "option" for the County, or BPL for that matter. We believe it would be in the best interests of both parties to have an independent expert examine the Arena periodically and to determine that it is in good condition and working order.

The County's failure to have the Arena inspected by an independent qualified engineer, even if such inspection was not otherwise provided for under the Management Agreement, is another example of the County's lack of meaningful contract administration. Had the County financed the construction of this facility by a bond issue of its own, the presence of a dedicated bond engineer most certainly would have occurred. Having an independent oversight function helps to ensure that the bond funds are used appropriately and that the product of the County's investment, in this case the Arena, is wisely managed and operated in accordance with good business practices.

OIG Recommendation No. 17

17. The County and BPL should meet to discuss how they will go about implementing the consulting engineer option and to formally agree, in future years, that they will periodically engage an independent engineer to inspect the Arena and site.

ISD Response to Recommendation No. 17

The County has discussed this matter with BPL and we will work to identify a third party engineer to periodically provide an independent assessment of the physical condition of the Arena.

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BPL Response to Recommendation No. 17

BPL conducts regular inspections of the facility through its full-time, internal maintenance engineering department. Expenses associated with the implementation of the work order/preventive maintenance program are included in the annual Operating and/or Capital Budgets, as applicable. BPL has proposed to the County that the parties work together during the annual budget process to select an independent qualified engineer.

FINDING No. 9 BPL has not been providing the County with written notice of legal actions nor has it been consistently advising the County of the progress of such actions.

Section 4.2.3	[the Manager shall] notify the County in writing of the commencement of any legal action or proceeding and advise the county of the progress of any such legal action or proceeding.
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BPL told the OIG that at times it has provided the County with telephonic notice and oral updates of legal actions. We confirmed with personnel from the County Attorney’s Office and the County’s Internal Services Department that, at times, they have received calls from BPL about legal actions. However, occasional notice is insufficient, especially when occurring solely at BPL’s discretion. We note that BPL has spent about \$2.4 million on legal fees during fiscal years 2005 – 2010; including approximately \$1.1 million for general attorney services and over \$462,000 (total fees net of recoupment to-date) for its lawsuit against the Arena architect (see Finding No. 12). The Arena is a County-owned property and the County should be made aware of any legal actions related to Arena operations and BPL’s management thereof.

One issue that could be addressed is how often notice—written or oral—is needed. We acknowledge that not all legal actions may justify immediate notice. For example, BPL told us that it is frequently the subject of “slip and fall” lawsuits filed by Arena patrons. Whether such individual actions should be reported immediately or perhaps combined in a quarterly report may be one way to simplify compliance with the required reporting requirement. Regardless, the County and BPL should establish regularly scheduled meetings during which BPL can update the County on the status of all legal actions, whether they are new or ongoing.

OIG Recommendation No. 18

18. The County should meet with BPL to develop procedures detailing how BPL will provide the County with written notice of future legal actions. In

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addition, BPL should disclose to the County how it handles legal actions, including whether it uses in-house or outside counsel and how it selects outside counsel. The County and BPL should establish regularly scheduled meetings as one means of ensuring that the County is properly noticed of new and ongoing BPL legal actions related to Arena operations.

ISD Response to Recommendation No. 18

County staff will consult with the County Attorney's Office to discuss how current and future legal actions will be addressed. The purpose will be to address the needs of the County in relation to these actions, if any.

BPL Response to Recommendation No. 18

BPL is proud of its record with respect to avoiding costly and time consuming litigation. During the time the Arena has been operating, the only potentially material legal proceeding that the Arena has been involved in was commenced by BPL in an attempt to recoup cost overruns in the construction of the Arena. BPL has proposed to the County to establish a formal notification process and clarify the nature and scope of progress reports.

SECTION 3 ARENA REVENUES

FINDING No. 10 The County is poorly informed about Arena Revenues that are used in BPL's Schedules of Management Agreement Computations.

Although the audit scope did not directly include an evaluation of the revenue generated by BPL, we did interview BPL about Arena Revenues, as reported in its Schedules of Management Agreement Computations. As noted earlier, this report summarizes Arena Revenues and Arena Operating Expenses that make up the calculation used to determine whether the County receives a share of Arena profits. Arena Revenues include "Premium Inventory" seating tickets for all events, concessions sales, event rentals, advertising, and certain other revenue producing activities. Arena Revenues do not include Ticketmaster sales of Arena general seating tickets for all events; these revenues are recorded on MHLP's books.

Arena Revenues that comprise the amounts used in the *Schedules of Management Agreement Computation* include monies derived mostly from the sale of Premium Inventory for all Arena events. Recent Premium Inventory sales total over \$20 million a year, and typically make up from 40% to 50% of total

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Arena Revenues. This inventory consists of suites, premium seating, and personal seat licenses (includes flagship courtside, star box, loge, center court, and end zone suites). Premium Inventory is multi-seat seating typically sold for multi-year periods, under contract with a purchaser. Unsold Premium Inventory is sold on an event-by-event basis through the Arena Box Office or BPL's sales department and is included as Arena Revenue.

Premium Inventory sales are important because they directly affect Arena Revenues that BPL uses in completing the Schedules of Management Agreement Computations. Unsold Premium Inventory is important because it represents lost revenue to BPL and potentially to the County.

BPL explained that every year a committee meets to set seat pricing and to review contract terms pertaining to revenue generation for the upcoming fiscal year. The committee consists of ownership, officers, and management personnel from both BPL and MHLP. There is no County representation at this meeting.

We find it disconcerting that the County has virtually no knowledge of what makes up Arena Revenues. Information about items such as: current contract terms and conditions of Premium Inventory sales and how they compare to prior years; what portion of Premium Inventory is unsold and how it compares to prior years; what portion of unsold Premium Inventory is later sold on an event basis and what are the terms of these sales; what are default rates of broken contracts; what is annual turnover; and what is BPL's marketing strategy to sell unsold inventory, is unknown to the County.

Another issue is BPL's use of "complimentary tickets."²⁷ When initially queried by the OIG about these tickets, BPL told us that it did not issue complimentary tickets for general Arena seating, i.e., non-Premium Inventory seating. However, later on, BPL told us that for each Heat home game there are complimentary tickets given to BPL and related entity employees, event marketers and promoters, etc.²⁸ We were told that there are written procedures governing the use of these but, as they are MHLP procedures, we were not

²⁷ License Agreement Section 6 allows MHLP to issue complimentary tickets for up to 10% of the total seating capacity of the Arena for Heat home games.

²⁸ The OIG also queried BPL as to whether County personnel or officials have been provided complimentary tickets to events at the Arena. BPL stated that no complimentary tickets have been given to County personnel or officials. At such time, BPL allowed the auditor to review a summary schedule that contained a listing by event of the complimentary tickets issued by MHLP. This schedule contained totals only. It did not indicate the recipients of complimentary tickets. In the event that County personnel or officials receive complimentary tickets, we trust that they are reported in accordance with Commission on Ethics guidelines.

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provided with a copy of them. BPL's handling of complimentary tickets is an important issue for the County because these tickets affect the Use Fee paid by MHLP to BPL, i.e., more complimentary tickets would reduce Use Fee revenues, which reduce Arena Revenues and the County's profit share potential.

Another critical issue that the County should be knowledgeable about is BPL's practices related to booking and pricing Arena use for non-Heat events. Between fiscal years 2005 - 2010, non-Heat events generated anywhere from 15% to 19% of total Arena Revenues. This makes BPL's handling and management of these events, activities that the County should be informed about. Additionally, the County and BPL should be concerned about competition from other venues, such as the new Marlin's stadium or Broward County's Bank Atlantic Center, and how the Arena can best be marketed to maximize revenues.

Other issues related to Arena Revenue (and operating expenses) include Arena configuration and space usage (e.g., the recently publicized prospective opening of the Hyde Nightclub inside the Arena) and third-party advertising (e.g., the media mesh). We believe that the County should have some practical understanding of, and input on, the financial impact of BPL's plans to maximize revenues.

In summary, through fiscal year 2011, even with Arena Revenues up almost 32% when compared to fiscal year 2010, Arena operations have not reported sufficient profit to allow County profit sharing. Yet, by all appearances, the County has shown little interest in familiarizing itself with BPL's stewardship of the facility, whether such interest relates to how BPL spends Arena funds, as we described earlier or, as we described above, how BPL generates Arena funds.

OIG Recommendation No. 19

19. The County should be more informed about the Arena Revenue that is included in the Schedules of Management Agreement Computations used to derive the "Arena Distributable Net Cash Flow" upon which the County's share of Arena profits is calculated. Steps that the County should consider include:
- Perform variance analyses between current year's actual revenues with prior year's actual revenues, and written requests to BPL asking for explanations and supporting detail, as necessary.
 - Develop an understanding of BPL revenue details, such as: main contract terms of the sales agreements; Premium Inventory sold

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versus unsold; pricing comparisons for the sold inventory and remaining contract periods for this inventory; and competition with other local venues for booking events.

- Request that a County representative attend the annual committee meetings held by BPL and MHLP personnel to set pricing, budgeting, and contract terms pertaining to the Arena. Implement reviews of BPL's actual contracts for sales of Premium Inventory.
- Periodic audits of event basis sales that would include a review of the sales terms and conditions of this Premium Inventory.
- Meet with BPL regarding its handling of complimentary tickets and to ascertain the financial impact of dispensing these tickets, i.e., impact on Use Fee.

ISD Responses to Recommendation No. 19 (bulleted suggestions)

- The County will compare current year's actual revenues with prior year's actual revenues and work with BPL to understand significant variances.
- With the formalization of the budgetary review process and the establishment of recurring meetings with BPL, a deeper understanding of revenue details will be developed.
- The County will discuss with BPL the possibility of having County staff at these meetings.
- The County reserves the right to audit any facet of the management agreement, when warranted. It should be noted however that a 'compliance report' as to BPL's adherence to the "terms, covenants, provisions, or conditions of Section 5.1 to 5.6" of the management agreement, as amended, is annually provided by PricewaterhouseCoopers, LLP. Such reports have indicated that BPL is in compliance with the Management Agreement.
- How BPL and/or the Miami Heat issue complimentary tickets and the impact on Use Fee will be discussed with BPL at an upcoming meeting.

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BPL Response to Recommendation No. 19

BPL has proposed to the County that the above-referenced quarterly meetings can and should be used to facilitate the County's understanding of the Arena Revenues to facilitate the County's ability to perform a variance analysis. In its response, BPL also describes various actions that it has proposed to the County to enable the County to better understand Arena Revenues.

OIG Rejoinder to ISD Response to Recommendation No. 19

The OIG takes issue with the County's reliance on BPL's independent certified public accountant's annual report as an indicator of compliance. Our concern is not that BPL was noncompliant with the Agreements; our concern is that the County does not have adequate knowledge of this issue. The County has no understanding of what comprises Arena Revenues; that revenues may be reported properly is not the same as understanding what underlies what is being reported. Moreover, notwithstanding the cited "compliance report" the Agreements give the County the right to audit BPL's financial activities, including revenues. As demonstrated by the OIG's audit, what internal auditors review and report on is not the same as that which BPL's external auditors review and report on. The County needs assurances from both types of auditors as part of an effective contract administration function.

SECTION 4 OPERATING EXPENSE ALLOCATIONS AND COSTS

FINDING No. 11 BPL recorded expense allocations have been inconsistent and not always supported by authoritative accounting records.

BPL and MHLP are separate entities, each with its own personnel and operating resources. However, on an on-going basis, certain personnel and operating resources are shared between the two entities. This arrangement necessitates periodic allocations between the two entities of the costs that are associated with providing these resources to the other. At times, BPL allocates resources to MHLP, and at times MHLP allocates resources to BPL.

We interviewed BPL management to determine its process and methodology used to calculate its cost allocations between the two parties. We also reviewed accounting records, other authoritative reports, and source documents related to these cost allocations. BPL informed the OIG that it developed its allocation process and methodology during the first year of Arena operations based on internal discussions among BPL staff; however, it did not

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document any of the decisions regarding cost allocations that were made in these discussions. In addition, while we learned that BPL has modified parts of its methodology related to training and merchandising salaries, we also learned that it has not reassessed the remaining components of its cost allocation methodology, including allocation percentages or allocated amounts, since the beginning of Arena operations in fiscal year 2000—at least not until OIG’s Auditors began asking BPL to explain what it had been doing over the past 10 plus years.

BPL explained that even though certain of the allocation percentages or allocated amounts have not changed through the years (e.g., for administrative expenses), it believes that the allocations are conservative for the benefit of BPL (and the County) instead of MHLP. We also observed that in some instances, certain allocations have stopped, such as MHLP copier expense to BPL and BPL training salary expense to MHLP; and certain allocations have begun, such as MHLP merchandising salary expense to BPL.

BPL provided us with documented support for audit period allocations (fiscal years 2005 – 2010), whether it be an allocation percentage or an allocated amount that attempted to show its process and methodology used to develop the allocations. Often, however, BPL’s “support” was nothing more than an oral explanation and a package of documents that it compiled based on our audit inquiry. The records produced did not always support BPL’s allocations and raised more questions about the allocations than they answered. At times, in attempting to explain its “old” allocations, BPL created new allocations. Each time, BPL’s new allocation reflected a higher percentage of costs attributable to Arena operations than had been recorded in its accounting records. We observed that when explaining itself, BPL focused on showing what party benefited from its allocations rather than showing that it consistently followed a fair, reasonable, and sound methodology. Notwithstanding BPL’s explanations --whether about its old or new allocations—we find BPL’s cost allocation methodology ad hoc and, as such, OIG auditors were unable to gain a basis for its allocations, both old or new.

Questionable Allocations

BPL provided support for an allocated amount (a recurring allocation) that was not consistent with its accounting records. BPL has recorded \$140,000 of allocated expenses (“net allocation of administrative costs”) from MHLP every fiscal year since the beginning of Arena operations. BPL records this allocation in a trial balance account labeled “Allocation from MHLP Health.” BPL, however, provided support for this allocation that showed this amount to be approximately

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\$110,000. Over our six-year audit period, this amounts to \$180,000 (\$30,000 x 6) of questionable recorded allocated expenses.

In attempting to support the above \$140,000 allocation, BPL also provided support for contract services and sponsor promotions incurred by MHLP for fiscal year 2010, totaling about \$208,000. However, BPL recorded these amounts in different trial balance accounts that appeared to be unrelated to the "Allocation from MHLP Health" account. Therefore, we did not accept this explanation and reaffirmed our questionable annual \$30,000 allocation.

Our review of MHLP copier and merchandising salary expenses determined that BPL's allocation percentages were not accurate according to the supporting documentation that it provided us. Furthermore, BPL did not consistently make these allocations from one fiscal year to the next. In these instances, we could not make a final determination about whether BPL allocated the correct amounts, or whether the noted expenses are properly allocable. In addition, we noted that MHLP's allocation to BPL for copier expenses occurred in fiscal years 2005 through 2007, but not in fiscal years 2008 through 2010.

Another inconsistent allocation has been a merchandising salary allocation from MHLP to BPL for fiscal years 2007 through 2010; however, this allocation was not made for fiscal years 2005 and 2006. Moreover, the MHLP merchandising salary allocation percentages actually recorded on BPL's books ranged from 8% to 22%, whereas a recent analysis performed by BPL staff in November 2011, shows that the percentages should have ranged from 45% to 49%. BPL did not provide us with support for its earlier allocation percentages but claims its support of the higher allocation percentages now apparently takes into account all events (basketball, non-basketball with merchandise sold, and non-basketball with no merchandise sold) that took place at the Arena during a fiscal year.

OIG Recommendation No. 20

20. The County and BPL should meet to discuss the methodologies utilized to allocate costs between BPL and MHLP, so that the County can approve the allocation percentages directly attributing to the Arena's annual operating costs as part of the budget process. Once allocation percentages have been established and approved, periodically, as part of a future audits or other in-depth reviews, the County should examine BPL's accounting records to ensure that the cost allocations are still reasonable and based on actual costs.

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ISD Response to Recommendation No. 20

The County will meet with BPL in the near future to review the cost allocation methodologies used between BPL and the Miami Heat.

BPL Response to Recommendation No. 20

BPL reviews its recorded expense allocations on an annual basis. These amounts are contained in the audited financial statements and BPL's payroll records are processed through the ADP system and retained in accordance with standard operating protocols. Allocated salaries and other operating expenses are contained in the Operating Budget, which were deemed approved by the County. BPL adds, "the standard of review for any past allocations falls within Section 5.11.3.3 which deems expenses reasonable if they were "customary in accordance with industry standards ..." BPL concludes by stating that it has proposed to the County to include in the annual budget process a review of the allocated expenses.

OIG Rejoinder to BPL Response to Recommendation No. 20

The OIG affirms its finding questioning the method by which BPL allocates certain amounts. We observed that BPL records did not support the amounts allocated; that BPL was inconsistent in its application of its methodology; and that its methodology was not documented. That these allocated amounts are contained in its audited financial statements is not support for its allocation methodology. Likewise, whether or not the allocations were approved by the County—which we do not concede—does not justify the allocation. Without such support, these will continue to be—in our assessment—questioned allocations.

FINDING No. 12 **Certain BPL expenses are inappropriate deductions when calculating the profit share provision.**

The OIG reviewed a sample of BPL expenditures to determine whether the cost items should be taken into account for the computation of the profit share provision. We identified expenses that the OIG believes should not be included in the Schedules of Management Agreement Computations.

In some instances, we believe that the cited expenses are unallowable, pursuant to the Agreements; in other instances, we believe that the cited expenses are not appropriate for consideration when calculating the profit share provision; and lastly, in one instance we question the amount included in the profit share calculation. In making these determinations, OIG Auditors were

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guided by the requirements of the Schedules of Management Agreement Computations and the definitional terms of the Management Agreement, including the definition of “Arena Operating Expense.”²⁹

- Legal fees incurred by BPL resulting from a lawsuit that it filed against the Arena’s architect. BPL is seeking \$15 million in reimbursement because of damages related to the use of substandard materials, extra or duplicate work performed, and inadequate record keeping during Arena construction. To date, BPL has spent \$1,265,000 on architect-related legal fees, including \$686,641 for fiscal years 2005 – 2010. BPL, to date, has recovered only \$225,000 in damages, which in the Schedules of Management Agreement Computations were used to reduce its legal fees. BPL stated that most of its legal expenses have been incurred and that it believes it will eventually collect a substantial portion of its remaining claim. BPL has been including these legal expenses in its Schedules of Management Agreement Computations as Arena Operating Expenses.

Notwithstanding BPL’s reporting that these are Arena operating expenses, the OIG draft report found that they should not be attributable to Arena management and operations, and they should not be considered as such when BPL prepares its Schedules of Management Agreement Computations. Pursuant to the Management Agreement, *Definitions*, 45 “Arena Operating Expenses” are “all costs, expenses and obligations made or incurred by the Manager in managing, operating and otherwise performing its duties in connection with the Arena as provided in this Agreement.” On face value, legal expenses for this type of lawsuit has to do with the construction of the facility and not the on-going operations of the facility.

Nevertheless, BPL in its response contends that one of the definitions found in the Agreement that excludes certain costs, by deduction permits the non-excluded costs to be allowed.³⁰ The OIG sees things differently—we see legal fees as distinct from BPL’s damages. But for the sake of this audit, we will not question the classification of the legal fees to recover construction damages as Arena Operating Expenses. Our recommendation, however, still stands. The County and BPL need to agree on how to account for recoveries of both its damage claims and its legal fees. In other words, recoveries should be matched to their cost objectives.

²⁹ Management Agreement, Exhibit 1, Definitions 45

³⁰ The definition of Arena Operating Expense expressly excludes: costs incurred to remedy any defect in design, materials or workmanship of the Arena, to the extent recovered from the contractor or architect performing the work or under any warranty or guaranty or under any payment or performance bond. Management Agreement, Exhibit 1, Definitions, 45(z)(i).

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- Executive compensation paid by BPL for one of its executives has been included in the Schedules of Management Agreement Computations as an operating expense. However, pursuant to Section 5.1.4 (c) of the Management Agreement, such compensation is not includable as Arena Operating Expenses.³¹

... The Management Fee (which shall cover the compensation of the general manager of the Arena or the general manager's functional equivalent and the compensation of those individuals to whom the general manager of the Arena reports, as well as the Manager's executive staff, none of which shall be Arena Operating Expenses ...)

We note that BPL backs out most of its executive salaries when preparing its Schedules of Management Agreement Computations, but one executive salary was not backed out.³² We believe that BPL should also exclude this executive's salary from the final computation. We note that BPL has been claiming this particular executive's salaries, as an Arena operating expense, since fiscal year 2001. The cumulative amount is large enough to warrant the County's review.

In addition, a more overreaching issue involves what comprises executive compensation for purposes of completing the Schedules of Management Agreement Computations. An issue is the lack of a formal definition of what is executive compensation. Through fiscal year 2010, BPL's executive compensation included such items as salaries, bonuses, and incentive payments, but did not include commissions. During our discussions with BPL regarding this issue, BPL expressed to us that it now believes that executive salaries are the sole component of executive compensation when preparing the Schedules of Management Agreement Computations. Apparently, in future years BPL will adjust its executive compensation deduction accordingly.

We disagree with BPL's change of position. It makes no sense to us that an executive's regular salary would not be an Arena operating expense

³¹ See also Management Agreement, Exhibit 1, Definitions, 45(z)(vi), executive salaries (including the general manager of the Arena or his functional equivalent) are expressly excluded from Arena Operating Expenses.

³² Under BPL's assertion that its executive compensation is protected under the "trade secret" clause (Assurance Agreement Section 22.22), we are not identifying which executive it is or his/her compensation amount.

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but his/her bonus would be. It is clear to us that the Management Agreement identifies executives as a group of individuals, whose pay is not included in the Arena operating cost equation. How much and in what manner MHLP/BPL pays them (salary, bonus, commission, incentive, etc.) is its call. The County has no say in the matter, nor should it. The same is true with the number of executives that MHLP/BPL carries on its organizational chart. So long as all of the executives are excluded from the Arena operating cost equation, the County has no interest. But when BPL picks and chooses what components of one's pay is included or excluded from the compensation determination, the County should be concerned. Having excluded executive bonuses, incentive payments, and commissions from the salary amounts "backed-out" of the final computation (i.e., BPL while backing out regular salary, left in the executive compensation amounts), BPL has adversely affected the Net Cash Flow. Annually, this is a significant amount warranting the County's attention. When combined with the individual's executive salary not backed-out as identified above, these two cost categories have materially reduced Net Cash Flow and the County's profit share potential over the last 10 years. The County needs to take steps to resolve this issue with BPL.

- Other Questionable Operating Expenses

The OIG does not dispute that the following costs are legitimate business expenses, but rather the OIG argues that they are not appropriate given the nature of the business arrangement, and accordingly BPL should not consider these costs as Arena operating expenses when calculating the profit share provision.

- Lobbyists (\$614,000 for fiscal years 2005 - 2010)
- Political contributions (\$12,300 for fiscal years 2005 - 2010)
- Charitable contributions (\$17,500 for fiscal years 2005 - 2010)³³
- Association memberships/dues (\$24,300 for fiscal years 2005 – 2010)

OIG Recommendations Nos. 21 - 23

21. The County needs to periodically review BPL trial balances; vendor payment reports; and source documentation (such as invoices, receipts, and contracts) to gain an understanding of specific operating and capital expenses being incurred for Arena operations.

³³ Originally reported as \$43,820 in our draft report.

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22. Regarding the architect lawsuit, the County and BPL should discuss how future recoveries will be classified.
23. The County should seek to review the OIG's work papers (both in the OIG's possession and at BPL's offices) regarding the questioned expense amounts identified by the OIG. The County should seek to claim these amounts (executive compensation, lobbyist fees, and political and charitable contributions) via an adjustment to a future Schedules of Management Agreement Computations.

ISD Responses to Recommendation Nos. 21 - 23

21. Please see response to OIG Recommendations for Section 1 - Recommendation # 7 above.
22. The County will discuss the matter with BPL to make certain that the charges are being applied correctly and make any necessary adjustments if they are not properly classified.
23. County staff is looking forward to meeting with the OIG and BPL to review the audit documents. Any warranted adjustments will be discussed with BPL.

BPL Response to Recommendation Nos. 21 - 23

21. BPL has proposed to the County a modification of the review process of BPL's expenses incurred for Arena operations. BPL has proposed a quarterly meeting with the County where any questions can be discussed.
22. BPL disagrees with the OIG's position and provides its interpretation of and citations from the Management Agreement related to legal expenses and their inclusion as Arena Operating Expenses. BPL states that it has properly, and in accordance with the Management Agreement, included its net legal expenses related to its lawsuit against the Arena architect, as Arena Operating Expenses. *(The OIG has modified its finding relative to legal fees based upon BPL's response.)*
23. BPL states that the specific language of the Agreements (See Definition of Arena Operating Expenses, Exhibit 1, Management Agreement) determines whether expenses are properly included as Arena Operating Expenses. The issue for BPL is whether the Agreements prohibit their inclusion as Arena Operating Expenses, which, in BPL's opinion, they do not.

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For example, BPL defends its lobbyist expenses, as services of a governmental affairs expert/liaison that are usual and customary for a business of its size and high profile and needed to support its in-house staff. BPL states that the fees associated with these services were openly reported in all of BPL's Operating Budgets and deemed approved by the County. BPL notes that throughout the OIG's report, BPL and the County are criticized for lack of communication with respect to the Agreements. In fact, however, the work performed pursuant to this budget line item was in large part related to non-County regulatory and legislative initiatives, as well as a liaison function to facilitate communications between BPL and the County.

In another example, BPL acknowledges the OIG's disagreement with BPL's position with regard to executive salaries, but it stands by its conclusion, which it believes is supported by the Agreement. BPL further stands ready, willing and able to discuss the particulars with the County and is confident no recoupment is appropriate.

BPL's maintains that political contributions are permissible Arena Operating Expenses. BPL explains its \$10,000 contribution to the 76th Annual U.S. Conference of Mayors (June 2008) "as an opportunity to support downtown commerce and community recognition." In addition, BPL asserts that the OIG has "mischaracterized" over \$33,000 as charitable contributions that it asserts were not charitable contributions. BPL explains that, among other things, these expenditures were "[a] refund of an event deposit, payments to event promoters by the licensee and a United Way employee donation pass-through."

BPL states that it will make available to the County for its review the OIG work papers located at its offices, as well as provide the County with supporting documentation substantiating its position.

OIG Rejoinder to BPL Response to Recommendation No. 23

We reiterate what we earlier stated in our rejoinder to BPL's response to our Finding No. 1. We observed that there is no evidence to support that this liaison/lobbyist met with the designated County Representative about BPL's Schedules of Management Agreement Computations or, for that matter, any of the other specific financial reporting issues that we address in this report. However, even if this retained liaison did meet with County officials about the Arena, we would still question these expenditures as deductible Arena Operating Expenses. This liaison/lobbyist would essentially be doing the job of BPL

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executives whose compensation is accordingly excluded from Arena Operating Expenses.

Regarding this individual's engagement, BPL did not maintain supporting documentation of this individual's activities and communications on BPL's behalf. Instead, BPL only maintained copies of this individual's requests for payment of its monthly retainer, with no descriptive information regarding the details of services performed. Further, we note that in BPL's footnote 2 to its response, that it states that "The very existence of these [lobbyist] expenses ... are proof positive of the regularity of the routine and consistent communication between the parties." We disagree. Vendor invoices should contain sufficient details as to the services provided before they can be considered authoritative support.

In addition, we reaffirm our positions regarding executive compensation that all executives and their compensation are excludable from the Schedules of Management Agreement Computations and that executive compensation should be considered broadly inclusive of all forms of executive compensation, not just executive base salaries.

The OIG also reaffirms its finding on political contributions as being inappropriate deductions when calculating the profit share provision. We find this true even for sponsoring of a mayoral conference. As for charitable contributions, after reviewing BPL's response, we adjusted our amount from \$43,820 (as shown in our draft report) to \$17,500. Notwithstanding our reconsideration of the amount, we reaffirm our finding that charitable contributions are inappropriate deductions when calculating the profit share provision. The same goes for the \$24,300 identified for associational memberships and dues, which, we note, was not refuted by BPL. Any BPL questions as to the allowability of these types of expenses should be discussed with the County.

* * * * *

In accordance with Section 2-1076(d)(2) of the Code of Miami-Dade County, the OIG requests that the County administration provide a status report in 90 days on the issues addressed by this audit. We request this report from ISD on or before August 29, 2012.

Lastly, the OIG would like to thank County staff and BPL management for making their records available to us in a timely manner and for the courtesies extended to OIG auditors during the course of this review.