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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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# Accounting and Cost Variance Information Related to Petco Park Development Project

## OVERVIEW

On November 9, 2009, the Audit Committee reviewed the City Redevelopment Agency's (RDA) financial statement audits for fiscal years 2003 through 2007. In response to questions from Councilmember DeMaio, independent auditor Macias Gini & O'Connell (MGO) and City Comptroller staff explained RDA audit findings and certain restatements to the FY 2003 RDA financial statements that were made to correct accounting errors in FY 2002 and prior year RDA financial statements. Following this explanation, Councilmember DeMaio requested 1) information from management on the internal control and compliance findings and the status of corrective actions for the fiscal year 2003 through 2008 RDA audits and 2) the IBA review the Petco Park development project as it relates to incorrect accounting/reporting and report on the variance between the project's initial cost estimate and final costs for the ballpark facility, acquired real estate, and other related capital expenditures.

This report comments on the information provided by management in response to item #1 above and provides a brief overview of the cost variances for the Petco Park project. This information is docketed for discussion at the Audit Committee meeting scheduled for January 11, 2010.

## FISCAL/POLICY DISCUSSION

### Comments on the Status of Corrective Actions to address Audit Findings related to Petco Park

At the Audit Committee meeting on December 7, 2009, the Office of the Comptroller presented a memorandum dated December 2, 2009 detailing the status of corrective actions taken to address RDA audit findings on compliance and internal control weaknesses. Of the cited findings, the Office of the Comptroller has informed the IBA that the accounting errors related to the Petco Park project have been corrected with restatements to the RDA CAFR in fiscal year 2003. Detail for all of the restatements is provided beginning on page 41 of the fiscal year 2003 RDA CAFR ([http://www.sandiego.gov/comptroller/reports/pdf/rdaaf\\_r\\_fy03.pdf](http://www.sandiego.gov/comptroller/reports/pdf/rdaaf_r_fy03.pdf)).

The most significant restatements related to the Petco Park project resulted from 1) improper classification and reporting of real estate assets and 2) inaccurate recording of long-term debt transactions. With respect to the improper classification and reporting of real estate assets, it should be noted that the Petco Park development was a complex redevelopment project which required the Centre City Development Corporation (CCDC) to acquire more than 50 properties to facilitate development of the ballpark. Additionally, the original Memorandum of Understanding (MOU) between the City, RDA, CCDC and the Padres was amended to change certain financial/estate responsibilities and a lawsuit halted construction for roughly two years.

Despite the aforementioned challenges, real estate asset financial reporting mistakes appear to be attributable to a lack of accounting guidelines, internal controls and adequate communication between CCDC/RDA staff and City Comptroller staff. The Office of the Comptroller provided the IBA with the following causes and corrective actions taken to date:

Real Estate Accounting Mistakes - Causes	Corrective Actions Taken To Date
The Agency did not have clear guidelines on how to classify an asset between Land Held for Resale and General Fixed Asset.	Developed guidelines, trained Agency staff and incorporated policies into management representation letters.
There were no detective measures in place for deletions.	Developed detective measures through the use of specific accounting codes.
There were no detective measures in place for non-cash transactions such as property conveyance and land in exchanged for debt.	Established detective measures through review of the Agency Board minutes and development of communication tools between Comptroller's Office and the Agency.
Responsibilities such as approval of payments and review of developer agreements were shared by various accountants without anyone having clear responsibility of ensuring that the inventory was correctly reported.	Responsibilities were transferred to one accountant and added review process by the accounting supervisor.
Responsibilities between the Agency and the Office of the Comptroller were not clearly defined.	Clarified responsibilities through newly established accounting policy.
Capital asset transactions were not monitored on an ongoing basis as it was a year-end project during a time when other financial statement responsibilities needed to be addressed.	Capital Asset Transactions are reconciled quarterly. Also, significant transactions are identified through the analysis of agreements approved by the Agency Board.
No policy was in place to reduce land held for resale to net realizable value.	Developed policy including property appraisals by the Real Estate Asset Dept. and the analysis of land sales terms on development and disposition agreements approved by the Agency Board.

Mistakes related to the inaccurate recording of long-term debt transactions are primarily described in restatement item 12 on pages 42 and 43 of the fiscal year 2003 RDA CAFR. Funds were advanced to the RDA by the Padres to buy land that would subsequently be conveyed back to the Padres once certain legal requirements were met for development of the land by the Padres. These funds were improperly recorded as revenue when they instead represented a liability to convey property back to the Padres. In order to correct this error, this restatement increased liabilities and reduced net assets by approximately \$27 million. There was also approximately \$2 million of issuance costs for ballpark debt improperly recorded as an expense in the first year rather than being expensed over the term of the debt. These accounting mistakes have been corrected. The Office of the Comptroller has informed the IBA that staff training and improved internal controls will prevent these types of mistakes from being repeated.

Project Cost Variances for the Petco Park Project

Following voter approval of Proposition C in November 1998, the MOU between the City, RDA, CCDC, and the Padres was entered into concerning a Ballpark District, construction of a Baseball Park, and a Redevelopment Project. Signed in December 1998, the MOU provided an initial summary of estimated ballpark project costs and funding totaling \$411 million. This cost estimate was split between ballpark facility costs (\$267.5 million) and land acquisition & infrastructure costs (\$143.5 million). Final ballpark facility costs grew to approximately \$294.1 million (a \$26.6 million increase) while land acquisition & infrastructure costs increased to approximately \$159.3 million (a \$15.8 million increase).

<u>Ballpark Costs</u>	<u>Initial Estimate – 1998</u>	<u>Final Costs</u>	<u>Variance</u>
Ballpark Facility	\$ 267.5 Million	\$ 294.1 Million	\$ 26.6 Million
Land Acquisition & Infrastructure	<u>\$ 143.5 Million</u>	<u>\$ 159.3 Million</u>	<u>\$ 15.8 Million</u>
<b>Total</b>	<b>\$ 411.0 Million</b>	<b>\$ 453.4 Million</b>	<b>\$ 42.4 Million</b>

The Ballpark, which opened in 2004, ultimately cost \$453.4 million according to source and use documents obtained from CCDC. The source of funding and total variance between the initial cost estimate and the final cost of the Ballpark are provided below:

<u>Ballpark Funding</u>	<u>Initial Estimate – 1998</u>	<u>Final Costs</u>	<u>Variance</u>
Padres/Private	\$115 Million	\$152.6 Million	\$37.6 Million
City/RDA	<u>\$296 Million</u>	<u>\$300.8 Million</u>	<u>\$ 4.8 Million</u>
<b>Total</b>	<b>\$411 Million</b>	<b>\$453.4 Million</b>	<b>\$42.4 Million</b>

Cost increases for the Petco Park project were largely attributable to the ballpark facility. The information above suggests that Ballpark facility cost increases were almost entirely covered by the Padres and other private development funding sources. As noted above, Petco Park was a complex redevelopment project that required approximately five years to complete and experienced a significant halt in construction after initial construction had begun. Along with typical unanticipated changes in project construction, these circumstances may explain much of the cost variance.

## CONCLUSION

In response to a request from Councilmember DeMaio at the Audit Committee meeting on November 9, 2009, this report provides information on audit findings and cost variances related to the Petco Park development project. Information has been provided to explain the nature of the largest and most significant accounting errors – improper classification/reporting of real estate assets and inaccurate recording of long-term debt transactions. It should be noted that cited accounting/reporting errors and audit findings were not limited to the Petco Park project. The IBA has been informed by the independent auditor (Macias Gini & O’Connell) and the Office of the Comptroller that, to the best of their knowledge, all of the independent auditor cited accounting/reporting errors related to the Petco Park project were corrected with restatements to the RDA CAFR in fiscal year 2003.

This report also comments on variances in project costs and funding sources for the Petco Park development project. The total cost of the ballpark project increased from its initial estimate of \$411 million to \$453.4 million, or approximately 10%. Petco Park was a challenging redevelopment project that experienced construction delays and required approximately five years to complete. It appears that most of the increased ballpark project costs were covered by the Padres and other private development funding sources.

**[SIGNED]**

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