

AUDIT REPORT



CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF MANAGEMENT AUDIT
WILLIAM C. THOMPSON, JR., COMPTROLLER

Audit Report on the Department of Citywide Administrative Services Collection of Rent Arrears

MJ08-053A

June 6, 2008



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

WILLIAM C. THOMPSON, JR.
COMPTROLLER

To the Citizens of the City of New York

Ladies and Gentlemen:

In accordance with the Comptroller's responsibilities contained in Chapter 5, § 93, of the New York City Charter, my office has examined the adequacy of Department of Citywide Administrative Services (DCAS) efforts to collect rent arrears from tenants and former tenants of City-owned property. The audit covered Fiscal Year 2007.

DCAS manages the City's real estate portfolio. It works to return properties to the City's tax rolls through sale at public auction or increase City revenues through short-term or long term lease agreements. Audits such as this provide a means of ensuring that agencies properly collect revenue due the City.

The results of our audit, which are presented in this report, have been discussed with DCAS officials, and their comments were considered in the preparation of this report.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please e-mail my audit bureau at audit@comptroller.nyc.gov or telephone my office at 212-669-3747.

Very truly yours,

A handwritten signature in cursive script that reads "William C. Thompson, Jr.".

William C. Thompson, Jr.

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*The City of New York
Office of the Comptroller
Bureau of Management Audit*

**Audit Report on the Department of
Citywide Administrative Services
Collection of Rent Arrears**

MJ08-053A

AUDIT IN BRIEF

This audit assessed the adequacy of the Department of Citywide Administrative Services (DCAS) efforts to collect rent arrears from tenants and former tenants of City-owned property.

The DCAS Division of Real Estate Services (DRES) manages the City's real estate portfolio of commercial, industrial, and waterfront properties, residentially-zoned vacant lots acquired through tax foreclosure or condemnation, and properties formerly managed by other City agencies. These properties are returned to the City's tax rolls through sale at public auction or increase City revenues through short-term or long term lease agreements.

Audit Findings and Conclusions

DCAS maintains adequate efforts to collect rent arrears. DRES collection procedures comply with Directive #21 and are consistently applied. In addition, DRES actively pursues all available activities and efforts to encourage tenants and former tenants to pay their arrears. This includes entering into payment agreements and conveying accounts to the Law Department for further collection proceedings once DRES has exhausted all of its internal collection efforts. However, of the \$31.1 million in arrears reflected in DRES records as of July 1, 2007, \$28.7 million represented a small number of special cases for which routine DRES collection procedures were not, and would not be, sufficient to encourage the tenants to pay. These arrears arose from long-standing disputes and contingencies, and remotely collectible accounts. Consequently, the adjusted arrears balance of \$2.4 million (exclusive of the \$28.7 million for these special cases) viewed in relation to the \$53 million in rental revenue collected by DRES in Fiscal Year 2007 strongly suggests that in general terms, DRES collection procedures are effective.

Some weaknesses were noted regarding terminated accounts with unpaid arrears transferred to the Law Department for further collection proceedings. Specifically, DRES does not have a benchmark time period to guide the transfer of terminated accounts for collection proceedings that would increase the likelihood of recouping payment from debtors. In addition, DRES does not adequately follow up on cases transferred to the Law Department, and does not have formalized write-off policies.

Audit Recommendations

To address these issues, the audit makes seven recommendations. Among them, we recommend that DRES should:

- Ensure that cases for which all internal collection efforts have been exhausted are transferred to the Law Department in a timely manner.
- Establish a benchmark (time period) for transmitting cases to the Law Department for collection and ensure compliance with this time frame so as to increase the likelihood of collection.
- Require that DRES establish ongoing communication with the Law Department to report on the status of accounts transferred for collection, especially those accounts that are not conveyed to the external collection agency.
- Develop formal write-off policies consistent with its operations.
- Review the current cases transmitted to the Law Department to determine whether any should be considered for writing off.

DCAS Response

Of the seven recommendations made in this report, DCAS generally agreed with all seven. The full text of the DCAS response is included as an addendum to this report.

INTRODUCTION

Background

The Department of Citywide Administrative Services (DCAS), Division of Real Estate Services (DRES), manages the City's real estate portfolio of commercial, industrial, and waterfront properties, residentially-zoned vacant lots acquired through tax foreclosure or condemnation, and properties formerly managed by other City agencies. These properties are returned to the City's tax rolls through sale at public auction or increase City revenues through short-term or long term lease agreements. Leased properties carry special use requirements specific to the unique nature of each property (i.e., public parking lots, retail spaces, office spaces, and vacant lots). In addition, rent structures vary from lease to lease. For example, rents may include one or more components such as base rent and additional rents, including payment in lieu of taxes (PILOT), escalation charges, and a percentage of the lessee's gross revenue from business operations.

Short-term leases (including month-to-month agreements, permits, and licenses) carry terms of less than one year, with rents ranging from under \$100 to \$5,000 per month. Long-term leases carry terms of longer than one year and are available on select properties. Both short-term lease properties with a monthly rent of more than \$5,000 and long-term lease properties must be offered through periodic, public lease auctions.

The DRES Financial Service Bureau (FSB) is responsible for generating and mailing monthly bills in advance of the first day of each month to active tenants, receiving and posting rent payments, and updating and maintaining tenant accounts. The DRES Lease Enforcement Unit (LEU) is responsible for initiating collection activities once a tenant account becomes past due. DRES uses two mainframe computer applications, the Tenant Accounting System (TAS) and Integrated Property Information System (IPIS). TAS is used to maintain and track all financial transactions associated with tenant accounts, and IPIS is used to track and record lease abstracts and milestones associated with collection activities undertaken by the LEU.

DRES sends a bill to active tenants in advance of the first day of each month. For "squatters" found on City property without a lease, subject to court order, DRES will assess and bill occupancy fees until the squatter is evicted or enters into a lease agreement. Rent payments are due on or before the 10th of each month. If a tenant's rent is not received by the 11th day of the month, the LEU will send a dunning letter to the tenant advising that the account is past due and that late charges for the current month will be assessed and billed on the next month's bill. Late charges are generally assessed at the greater of two percent of the balance due or \$10 for each month the balance remains unpaid.

On the first of each month, the LEU reviews the Arrears Report generated by the Management Information Systems (MIS) Unit to identify tenant accounts that are two or more months in arrears. For such accounts, the LEU will prepare a case file and initiate further collection procedures. These include first attempting to contact the tenant by telephone, followed by a default notice (for long-term leases only), then a three-day notice served upon the tenant demanding payment in full. If the tenant remains in default, the LEU will proceed to petition the courts to evict

the tenant and DCAS to take possession of the property. DRES will also seek to obtain a money judgment against the debtor. In addition to nonpayment of rent, DRES may take action to take possession of properties from tenants who fail to uphold lease provisions, from “squatters” who use City property without a lease agreement, and for properties that are to be used in City development projects. Generally, any time prior to DRES taking legal possession of the property, DRES will enter into a payment agreement with the tenant, if so requested. If the payments are made as agreed, no further legal action will be taken against the tenant.

Once DCAS obtains possession of the property, it will classify the defaulted account as terminated. If the arrears remain unpaid after exhausting all internal collection efforts, the LEU will either transfer the account to its internal Legal Unit or to the New York City Law Department (Law Department) for further collection pursuits.

For Fiscal Year 2007, DCAS reported total rental income of \$53 million.¹ As of June 30, 2007, DRES records reflected \$31.1 million in rent arrears consisting of \$18.1 million in arrears for 105 of 587 total active tenant accounts² and \$13 million for 209 terminated accounts.³

Objective

The objective of this audit was to determine the adequacy of DCAS efforts to collect rent arrears.

Scope and Methodology

The audit scope covered rent arrears outstanding as of July 1, 2007. To accomplish our objective, we carried out the following procedures.

To gain an understanding of DCAS roles and responsibilities over the leasing of non-residential, City-owned property, we reviewed the New York City Charter, the Fiscal Years 2006 and 2007 *Mayor’s Management Report*, Executive Budget, and Comptroller’s *Comprehensive Annual Financial Report*, and other relevant information obtained from the DCAS Web site and other sources.

Review of Controls

To gain an understanding of and to evaluate the manual and automated processes and controls involved in the monthly rental billings and activities employed to collect rent arrears we: reviewed DRES policies and procedures, organization charts, and operational flow diagrams; interviewed DRES officials and staff from the FSB and LEU; and conducted walkthroughs and observations of these units. We determined whether adequate controls were in force. Further, we determined whether DRES policies and procedures were reasonable and

¹ As reported in the Comptroller’s *Comprehensive Annual Financial Report for Fiscal Year 2007*.

² Active accounts are for those leases that remain in effect and the tenant retains possession of the property.

³ Terminated accounts refer to terminated leases in which the tenant has vacated and DCAS has regained possession of the property.

complied with requirements of Comptroller's Directive #1, "Principles of Internal Control," and Directive #21, "Revenue Monitoring." These rules and regulations, along with DCAS policies and procedures were used as criteria to evaluate the adequacy of DCAS's efforts to collect rent arrears.

We also reviewed the DCAS Directive #1 Financial Integrity Statement filing (which represents an internal control self-assessment) covering calendar year 2006 that was submitted to the Comptroller's Office. Further, we reviewed two previous audits of the former Department of General Services⁴ (DCAS's predecessor agency) regarding the collection of rent arrears that were conducted by the Comptroller's Office.⁵ We noted findings and conditions in those audits that addressed our audit objective or other matters relevant to this audit.

To assess DRES handling of accounts deemed uncollectible after exhausting all reasonable collection efforts, we reviewed the DCAS write-off policy. We also interviewed officials from the Comptroller's Office of Law and Adjustment and Bureau of Accountancy to assess approval and authorization requirements for settlements (i.e., stipulation agreements) and write-off of uncollectible debts, respectively. We also interviewed officials from the Law Department directly involved with handling DRES cases against defaulted lessees.

Tests of Data Reliability

We reviewed the user manuals for TAS and IPIS and familiarized ourselves with the applications' functions to assess the relevance of the databases to our audit. Further, we interviewed the DRES Director of Management Information Systems (MIS) to gain an understanding of the general controls over these applications. We obtained read-only access to TAS and generated various queries to evaluate the accuracy of the data therein. Also, using the initial sample of 19 active tenant accounts and 13 terminated accounts (discussed below), we compared selected information (i.e., billing and payment dates, amounts, late charges, et. al.) recorded in the lease files (source documentation) to the corresponding data recorded in TAS. We also reconciled monthly billings and cash receipts amounts for Fiscal Years 2005 through 2007 to the monthly arrears reports to determine the accuracy of the outstanding arrears reported on July 1, 2007.

With the assistance of LEU personnel, we obtained printouts of the milestone dates recorded in IPIS and compared the data in the printouts to the source documentation for the same 19 active and 13 terminated accounts.

⁴ Established by Local Law in 1996, DCAS is a consolidation of the former Department of Personnel and the municipal supplies, real estate, facilities maintenance, and administrative divisions of the former Department of General Services.

⁵ Office of the New York City Comptroller, *Audit Report on the New York Department of General Services' Procedures for Collecting Rent Arrears from Former Tenants of City-Owned Properties*, (#ME90-109) issued July 25, 1990, and *Follow-up Review of the Department of General Services' Collection of Rent in Arrears*, (#MG95-062F) issued June 30, 1995.

Based on these tests, we determined that both TAS and IPIS were reliable for audit purposes.

Selection of Accounts for Audit Testing

We obtained a copy of the DRES Rent Arrears Report for Active Accounts as of July 1, 2007, that reflected 105 active accounts with rent arrears totaling \$18.1 million. In addition, we obtained from DRES officials a separate report of terminated accounts that reflected 209 such accounts with arrears totaling \$13 million as of July 1, 2007. We stratified active and terminated accounts by tenant type or collection status and judgmentally selected one or more of the accounts with the highest dollar amount(s) in each stratified group. No distinction was made for long- or short-term leases.

From the July 1, 2007 active and terminated arrears reports, we judgmentally selected a total of 77 (25%) accounts with arrears of \$20.9 million (67%) from the population of 314 accounts with total rent arrears of \$31.1 million (see Appendix A). These 77 sampled accounts included 64 active accounts with arrears totaling \$17.4 million and 13 terminated accounts with arrears totaling \$3.5 million.

In addition, to test late fees we judgmentally selected a separate sample of 5 of the 75 active accounts that appeared on the July 13, 2007 “Late Fees to Be Billed” (Late Fees) Report and that were billed late fees for July 2007.

Tests Involving Active Accounts

To determine whether DRES collection procedures were carried out consistently and in a timely manner, from the 69 (64 from the rent arrears report and 5 from the late fees report) sampled active accounts we tested 24 accounts consisting of the following:

- 14 accounts with arrears totaling \$165,826 more than 60 days as of July 1, 2007. These accounts represented the cases for which the LEU initiated collection procedures in July 2007;
- 5 accounts with arrears totaling \$28,997 selected from the July 13 2007 Late Fees Report. These accounts represented accounts that were late in paying their rent for July 2007; and
- 5 accounts in arrears more than 60 days, including 3 accounts with arrears totaling \$16.7 million being handled by parties outside the LEU and 2 accounts from hold-over proceedings—accounts for which DRES had obtained orders from the courts for the tenants to vacate and was awaiting further actions by the Law Department to address issues raised by the tenants in response to the legal proceedings.

For each of these 24 accounts, we obtained and reviewed the case files (e.g., lease agreements, correspondence, collection letters, stipulation agreements, notices of petition), evaluated the components of the related account balances in TAS, abstracted the significant events of each account, and determined whether all collection milestones were met and appropriately documented.

For the five accounts from the July 13, 2007 Late Fee Report, we also evaluated whether late charges were appropriately billed in the subsequent month (August 2007).

We reviewed the TAS records for each of the remaining 45 sampled active accounts with rent arrears, totaling \$560,837 as of July 1, 2007, to confirm the status of the accounts and the individual account balances.

Tests Involving Terminated Accounts

To evaluate the status of terminated accounts and assess DRES's actions on such accounts, we reviewed the case files for the 13 sampled terminated accounts, abstracted the significant events of each account, and evaluated the components (i.e., base rent, PILOT, late charges, and payments) of the related account balances in TAS. Eight of these 13 sampled terminated accounts were selected from the grouping of 162 accounts with arrears totaling \$9.9 million that DRES had transferred to the Law Department between 1987 and 2007 for further collection activities. For each of these eight accounts, we also determined whether all applicable collection milestones were met and were appropriately documented.

To assess the status of all 162 terminated cases sent to the Law Department and DRES procedures for following up on those cases, we reviewed the TAS details for each account. We calculated the time elapsed between the date each account was terminated and the date the account was transferred to the Law Department. Subsequently, we compared the DRES list of 162 transferred accounts to the October 2007 status report submitted to DRES by Leopold, Gross, and Sommers, P.C. (LGS)—the law firm under contract with the Law Department to provide collection and litigation services—to identify accounts conveyed to LGS by the Law Department. Further, we determined whether the outstanding balances on the LGS reports concurred with DRES records, whether any accounts had been collected, and whether such payments were reflected in TAS.

Lastly, we obtained and analyzed documentation for Fiscal Years 2005, 2006, and 2007 (through December 2006) that supported write-offs of accounts deemed uncollectible and settlements of other accounts necessitating write-down of extinguished debt. We compared the bad-debt write-offs to the terminated accounts transferred to the Law Department to determine whether any of the terminated accounts had been written off.

The results of tests involving these sampled case files were not projected to the respective population due to variations in the terms, conditions, and payment structure or arrangements of each lease. Nevertheless, the sample test results provided a reasonable basis for us to assess the adequacy of DCAS efforts to collect arrears from tenants.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included tests of the records and other auditing procedures considered necessary. This audit was performed in accordance with the New York City Comptroller's audit responsibilities as set forth in Chapter 5, §93, of the New York City Charter.

Discussion of Audit Results

The matters covered in this report were discussed with DCAS officials during and at the conclusion of this audit. A preliminary draft report was sent to DCAS officials and discussed at an exit conference held on May 5, 2008. On May 7, 2008, we submitted a draft report to DCAS officials with a request for comments. We received a written response from DCAS officials on May 21, 2008. In their response, DCAS officials generally agreed with the audit findings and all seven of the audit recommendations. DCAS officials stated:

“We have reviewed the Draft Audit Report dated May 7, 2008. We have found the Report to be a fair assessment of the arrears collection process employed by the Division of Real Estate Services, and agree with the Report’s conclusions. In particular, we are pleased to see that the Report finds that ‘DCAS maintains adequate efforts to collect rent arrears’, and that ‘DRES actively pursues all available activities and efforts to encourage tenants and former tenants to pay their arrears.’ . . . We thank the Auditors for their efforts on this Audit.”

The full text of the DCAS response appears as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

Our audit determined that DCAS maintains adequate efforts to collect rent arrears. DRES collection procedures comply with Directive #21 and are consistently applied. In addition, DRES actively pursues all available activities and efforts to encourage tenants and former tenants to pay their arrears. This includes entering into payment agreements and conveying accounts to the Law Department for further collection proceedings once DRES has exhausted all of its internal collection efforts. However, of the \$31.1 million in arrears reflected in DRES records as of July 1, 2007, \$28.7 million represented a small number of special cases for which routine DRES collection procedures were not, and would not be, sufficient to encourage the tenants to pay. These arrears arose from long-standing disputes and contingencies, and remotely collectible accounts. Consequently, the adjusted arrears balance of \$2.4 million (exclusive of the \$28.7 million for these special cases) viewed in relation to the \$53 million in rental revenue collected by DRES in Fiscal Year 2007 strongly suggests that in general terms, DRES collection procedures are effective.

We also noted some weaknesses regarding terminated accounts with unpaid arrears transferred to the Law Department for further collection proceedings. Specifically, DRES does not have a benchmark time period to guide the transfer of terminated accounts for collection proceedings that would increase the likelihood of recouping payment from debtors. Therefore, several years may elapse between the time an account is terminated and when it is subsequently referred to the Law Department for collection action. In addition, we noted that DRES does not adequately follow up on cases transferred to the Law Department. Further, even though DRES complies with Directive #21 regarding the writing-off of accounts deemed uncollectible and amounts extinguished in settlements, it has no formalized write-off policies; therefore, the writing-off of accounts is not consistently applied.

These matters are discussed in greater detail in the following sections of this report.

DCAS Maintains Adequate Collection Procedures

DCAS maintains adequate efforts to collect rent arrears from tenants and former tenants of City-owned properties in compliance with Comptroller's Directive #21, which states: "Agencies should make every effort to collect all debts due the City with effective, vigorous, well-documented internal collection procedures."

Results of audit tests of sampled accounts and related source documentation provided reasonable assurance to conclude that in all material aspects, DRES followed its collection procedures and adequately documented its efforts. DRES actively employs acceptable collection activities and pursues available legal means to encourage tenants and former tenants to pay their arrears. This includes entering into payment agreements, seeking money judgments in the courts, and conveying accounts to the Law Department after DRES has exhausted all of its internal collection efforts. When disputes arise, based on the prevailing circumstances, DRES will seek to negotiate a settlement with the tenant (or former tenant) to secure payment of arrears.

For the 14 sampled accounts with arrears of \$165,826 for which DRES initiated collection actions in July 2007 because the accounts were more than 60 days past due, we found that the LEU carried out all applicable procedures in a timely manner in accordance with the DRES collection procedures. We confirmed that dunning letters were automatically generated and sent to tenants on the 13th of the month. Further, the LEU attempted to contact the tenants by telephone, and when applicable, sent a default notice (for long-term leases only) and served a three-day demand letter. All activities performed were appropriately documented in the case files and in IPIS. Further, we verified that the LEU billed the appropriate late fees on the advance monthly billing for August 2007 for the five accounts with arrears of \$28,997 sampled from the July 13, 2007 Late Fees report.

Based on our review of the status of the sampled accounts as of October 16, 2007, DRES collected \$185,586 (95%) of \$194,823 in arrears for 18 of the 19 accounts. The remaining account, ESL Home Remodeling had arrears of \$9,237 as of July 1, 2007, and defaulted on this account in August 2006. After exhausting all collection efforts, DRES finally obtained an order of eviction on August 6, 2007, and took physical possession of the property on August 21, 2007. As of October 16, 2007, the former tenant had arrears totaling \$11,298 (including late charges). This account was referred to the Law Department for collection pursuits.

Of the remaining 50 sampled active accounts with arrears as of July 1, 2007, we noted the following:

- 43 accounts with arrears of \$482,134 were less than 60 days past due as of July 1, 2007. Therefore, in accordance with its procedures, DRES did not initiate internal collection procedures in July 2007.
- 2 accounts with arrears of \$48,912 as of July 1, 2007, had hold-over proceedings. DRES had obtained orders from the courts for the tenants to vacate and was awaiting further actions by the Law Department to address issues raised by the tenants in response to the legal proceedings.
- 2 accounts with arrears totaling \$15.3 million for one tenant, Walker Street Chung Pak LDC. As discussed below, these accounts involved a long-standing dispute over charges that DRES calculated and billed for payment in lieu of taxes (PILOT) and escalation fees. These accounts were conveyed to, and, as of the end of audit fieldwork, were being addressed by the Law Department.
- 1 account with arrears of \$1.4 million involved an ongoing dispute over the lease with the Long Island Railroad branch of the Metropolitan Transit Authority. As discussed below, this case was being addressed by the Mayor's Office and other agencies external to DRES (discussed below).

In a small number of instances, we noted minor delays in the collection proceedings once they involved third parties, such as process servers. For collection actions that involve legal proceedings, court orders, and external collection pursuits, DCAS must depend on the

cooperation and timely action of the City Marshals, the City Sheriffs, the courts and the Law Department; therefore, we could not fairly assess the timeliness of these actions.

Nevertheless, overall, our review provided sufficient evidence to support our conclusion that DRES maintains adequate collection activities and actively pursues tenants in arrears to secure payment of debts. However, these actions may not always prove effective in encouraging debtors to pay arrears. Therefore, DCAS actively seeks assistance from the Law Department to either negotiate cases or pursue further collection proceedings.

Assessment of \$31.1 Million in Total Arrears

Even though DCAS actively pursues collection of arrears from tenants and former tenants, disputes, contingent receivables, and the remote collectibility of older cases transferred to the Law Department for collection pursuits have contributed to the accumulation of \$31.1 million in arrears being reflected in DRES records as of July 1, 2007. Considering that DRES collected \$53 million in rent income during Fiscal Year 2007, after adjusting the July 1, 2007 arrears for these special situations there is a strong indication that the DRES collection activities are generally effective.

As shown in Table I below, there were four accounts (two accounts for one tenant) with arrears totaling \$18.9 million (61%) out of the 314 past due accounts with arrears of \$31.1 million reflected in DRES records as of July 1, 2007. In addition, there were 162 accounts with arrears totaling \$9.9 million transmitted to the Law Department between 1987 and 2007 for either litigation or external collection proceedings that remain outstanding in DRES records. Based on our analysis of these accounts and their age, and the low collection rate of the Law Department’s external collection agency (discussed below), we determined that the likelihood of recouping payments on these terminated accounts is remote, at best.

Table I

Status of \$31.1 million in Total Arrears as of July 1, 2007

Item	Active Accounts	Terminated Accounts	Grand Total
Total Arrears per DRES Arrears Report as of 7/1/2007	\$18,099,230	\$12,998,961	\$31,098,191
<i>Less: Accounts for which the extent of collection not estimable</i>			
• Walker Street Chung Pak Local Dev Corp* (Being negotiated by the Law Department)	\$(15,288,113)		\$(15,288,113)
• Long Island Rail Road (Handled by officials and agencies outside of DRES)	\$(1,365,000)		\$(1,365,000)
• Public Health Research Institute (Contingent Receivable)		\$(2,211,431)	\$(2,211,431)
<i>Less: Arrears for which collectibility is unlikely</i>			
• 162 Terminated accounts transferred to the Law Department	_____	<u>\$(9,855,623)</u>	<u>\$(9,855,623)</u>
Adjusted Arrears as of July 1, 2007	<u>\$1,446,117</u>	<u>\$931,907</u>	<u>\$2,378,024</u>

*Note: Walker Street Chung Pak LDC included three separate accounts; two represent the \$15.3 million in arrears noted above and the third account was paid as of July 1, 2007.

The four accounts involved three separate tenants. As discussed below, two accounts involve long-standing unresolved disputes between DCAS and the tenants—Walker Street Chung Pak LDC and the Metropolitan Transit Authority-Long Island Railroad—that have impeded rent payments and resulted in accumulating rent arrears. The other case involves the New York City Public Health Research Institute, whose balance is deferred and whose payment is contingent on future licensing income (discussed below).

Walker Street Chung Pak LDC (WSCP)

As of July 1, 2007, WSCP, a non-profit organization, owed DCAS \$15.3 million on two leases held for residential and commercial property at 125 Walker Street, Manhattan. This City property was used to construct a building housing 88 residential units for senior citizens, a community center, and retail space. In 2000, a dispute arose over DCAS's reassessment and retroactive billing of higher PILOT and rent escalation charges. Since that time, in addition to monthly rents, these accounts have accumulated late charges and interest fees. On March 12, 2004, DRES referred this case to the Law Department for negotiations. At a meeting on March 5, 2008, DRES officials informed us that the cases were near settlement and provided us with copies of communication between the Law Department and Chung Pak representatives. Nevertheless, as of the end of audit fieldwork the final settlement amount and its terms had not been approved. Therefore, we were precluded from estimating an expected collection amount or learning the terms of such collection.

Metropolitan Transit Authority (MTA)-Long Island Railroad (LIRR)

DCAS has a long-standing unresolved issue with the MTA regarding an expired, long-term lease for a railroad right-of-way for the Atlantic Branch, a 9.1-mile-long rail line in the bed of Atlantic Avenue between Jamaica, Queens, and Flatbush, Brooklyn. The right-of-way was initially leased to the LIRR in 1877. The City became the landlord for the agreement under the 1940 Subway Unification Plan, and the lease was amended. The LIRR paid quarterly payments in the amount of \$48,750 (\$195,000 annually) until the lease expired on May 31, 2000. Despite DCAS attempts to negotiate a new agreement with the MTA, the matter has remained unresolved. Therefore, since the time of the lease expiration, DRES has continued to bill the MTA account \$48,750 quarterly, so that as of July 1, 2007, the account showed an outstanding balance of arrears totaling \$1.4 million. According to DRES officials, this matter has been handled at higher levels of authority than theirs within DCAS and external agencies, including the Mayor's Office. Until a resolution is negotiated, DRES continues to bill the account the quarterly rent under the expired lease.

Public Health Research Institute (PHRI)

In December 1985, PHRI, a non-profit organization, entered into a lease agreement with the former Department of General Services for 62,865 square feet of space at 455 First Avenue, Manhattan, for a 10-year term, July 1, 1986, through June 30, 1996. Under the lease agreement

PHRI was obliged to pay a base rent, PILOT, and escalation fees to the City. On June 1, 1991, PHRI defaulted in the payment of its rent. Following various legal actions, on August 31, 1994, PHRI entered into a stipulation agreement under which it transferred common stock in another corporation, valued at more than \$1 million, to the City and assigned a portion of future licensing income from certain patents to the City in payment of the balance of monies due for past and prospective rent and other charges. Under the agreement, the only source of payment for the balance due would be derived from the City's share of PHRI's licensing income. Therefore, the payment of the \$2.2 million in arrears reflected in DRES records on July 1, 2007, is contingent on uncertain earnings from future PHRI licensing.

An e-mail we received from the Law Department on January 2, 2008, reflected a lack of certainty about the actual balance of PHRI's account. We were informed that the stock was sold for \$1,044,900 in 1996, and small amounts of licensing revenue have been received since. We attempted but were unable to reconcile the DRES balance in accordance with the agreement and the information provided by the Law Department. Therefore, the actual balance due and collectibility thereof remained unclear.

Based on these circumstances the potential amount that DRES could expect to realize on these arrears was not estimable. Nevertheless, because of the unique factors involved with each case, routine DRES collection procedures were not, and would not be, sufficient to encourage the tenants to pay arrears. Based on information provided by DRES, 162 cases with arrears totaling \$9.9 million were transferred to the Law Department between 1987 and 2007 for further collection proceedings after DRES had exhausted all of its internal collection proceedings. However, based on our analysis of these transferred cases (discussed later in this report) the likelihood of securing payment is remote.

Lack of Timeliness in Transmitting Terminated Cases to the Law Department

Our analysis of 162 terminated accounts transferred to the Law Department for collection proceedings after DRES exhausted its internal procedures determined that DRES did not act in a timely manner in referring cases so as to increase the likelihood of collection.

While the LEU procedures manual does not specify precisely when an unpaid, terminated account should be transferred to the Law Department, it states that once the LEU terminates an account, if a balance remains due on the account and the former tenant fails to respond to DRES demands for payment, a case file is prepared that is subsequently forwarded to the Law Department for further collection efforts.

The DRES list of 162 unpaid, terminated accounts transferred to the Law Department between 1987 through 2007 (through June 18, 2007) contained 150 accounts with measurable dates. As reflected in Table II below, for these 150 accounts, with arrears totaling \$9.2 million, 2.8 years, on average, elapsed (ranging from 1 day to 12.2 years) between the time DRES terminated the accounts and the time DRES transferred them to the Law Department for collection proceedings.

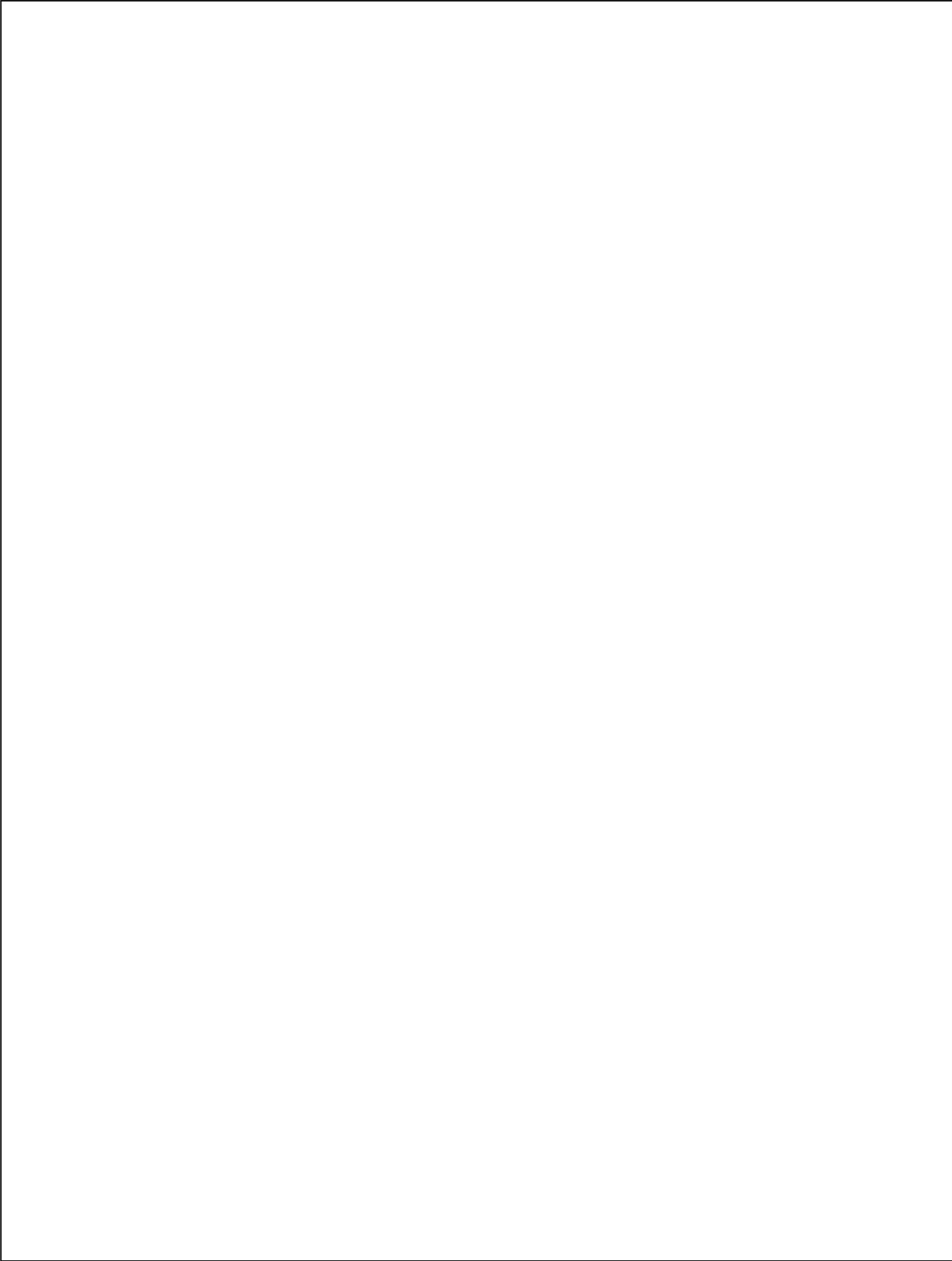


Table II

Time Elapsed Between Termination Date and Referral Date
For 150 of 162 Terminated Accounts Referred to the Law Department
Calendar Year 1987 through June 30, 2007

Year(s) Cases Referred	Total Cases Referred	Total Amount of Arrears	Average Time (in Years) Elapsed Between Termination and Referral Dates
1987 to 1992	20	\$1,291,346	0.5
1993 to 1997	30	\$4,231,281	1.6
1998 to 2002	29	\$3,149,538	2.1
2003	0	\$0	n/a
2004	45	\$289,183	5.0
2005	4	\$13,887	3.2
2006	19	\$218,549	2.6
2007	3	\$39,891	0.8
Total	150	\$9,233,675	2.8 yrs

Even though the above analysis shows a decrease in the amount of arrears for cases transferred to the Law Department after 2002, suggesting greater effectiveness of DRES collection efforts in securing payment from debtors, DRES needs to ensure that cases are transferred to the Law Department in a timely manner. This is especially true since the age of a transferred account itself could be much greater when considering the time elapsed between the date the account went into default and its termination date (not assessed). The likelihood of collecting a past due debt diminishes the older the debt becomes. Therefore, the longer it takes DRES to transmit cases to the Law Department for collection proceedings, the less likely the past due accounts will be collected.

Recommendations

DRES should:

1. Ensure that cases for which all internal collection efforts have been exhausted are transferred to the Law Department in a timely manner.

DCAS Response: “We agree. This has been incorporated into our written write-off policies.”

2. Establish a benchmark (time period) for transmitting cases to the Law Department for collection and ensure compliance with this time frame so as to increase the likelihood of collection.

DCAS Response: “We agree. This has been incorporated into our written write-off policies.”

Lack of Follow-up on Cases Transferred to the Law Department

Even though DRES complies with Comptroller's Directive #21 by transmitting cases to the Law Department for litigation or external collection agency proceedings once internal collection methods are exhausted, DRES does not maintain sufficient communication with the Law Department to follow-up on the status of the transmitted cases.

Our review of the case files for eight of the 162 terminated cases transmitted to the Law Department and follow-up discussions with DRES officials disclosed that DRES had limited information on the status of the 162 terminated cases with arrears, totaling \$9.9 million. According to DRES officials, once a case is transferred to the Law Department, DCAS's responsibility for the account ends. The Law Department decides which cases it will handle and which cases it will refer to LGS (its external collection firm). For those cases sent to LGS, each month DRES receives a status report from LGS listing the cases referred to the agency by the Law Department for collection actions, the amount due on each account, any collection amounts, and the last collection action taken by LGS. This is the only active, periodic communication between DRES and the Law Department or its contractor regarding the status of accounts transferred for collection proceedings.

Based on the October 2007 LGS status report, we identified 53 (33%) accounts with arrears, totaling \$714,634 (7.3%), that appeared on the LGS report of the 162 terminated accounts with arrears of \$9.9 million that DRES transferred to the Law Department between 1987 through 2007. DRES had no information on the status of the remaining 99 (67%) accounts with arrears of \$9.2 million.

Even though the Law Department is responsible for determining the collection actions to be taken on the cases transferred by DCAS, DRES maintains these accounts in TAS and the associated outstanding balances are reflected in DCAS rent arrears. Since the Law Department did not refer two-thirds of the 162 transferred to LGS for collection, it would be beneficial for DRES to request periodic updates on the status and handling of these accounts. This information could be used in maintaining the accuracy of TAS as well in DCAS determining its future revenue projections.

Monthly Status Report from External Collection Firm Not Reconciled

Our analysis of the October 2007 LGS status report disclosed that the balance due for 12 of the 53 accounts listed on the report differed from the balances appearing in TAS by \$89,679. We learned that DRES does not periodically reconcile the LGS reports to TAS records; therefore, DRES officials were unaware of this discrepancy until we presented them with this finding. Subsequently, DRES officials researched the 12 accounts and provided us with reasonable explanations for the differences for 9 of the 12 accounts. Primarily, the differences were due to additional charges accrued or payments received that were recorded in TAS but were not reflected in the amount of money judgments. Even though the total difference of \$89,679 represents 12.5 percent of the total amount reflected in TAS for the 53 accounts referred to LGS by the Law Department and represents less than one percent of the total \$9.9 million for the 162 cases that DRES transferred to the Law Department, DRES must assure itself of the

accuracy of transactions or be certain that it updates the Law Department of any additional charges or payments or other adjustments required to the balance due on accounts referred for collection actions.

In addition, we noted that the status report reflected payments of \$14,947 for four accounts that had original balances of \$93,981. However, when compared to the respective accounts in TAS, DRES had only credited one of the four accounts for \$500. Further, we identified two accounts that LGS deemed as uncollectible. According to the account status codes indicated on the LGS report, one account was deemed uncollectible because it was “unsuitable for litigation” and the other because of “bankruptcy discharge.” However DCAS had not updated TAS to reflect the status of these accounts.

Recommendations

DCAS should:

3. Require that DRES establish ongoing communication with the Law Department to report on the status of accounts transferred for collection, especially those accounts that are not conveyed to the external collection agency.

DCAS Response: DCAS generally agreed, stating: “Past practice had been to periodically review with the Law Department previously referred terminated accounts. On a quarterly basis, DCAS will now review the list of accounts referred to the Law Department to identify those that can be written off. Accounts referred to the Law Department’s collection agency that have been terminated for three years or more will be written off.”

4. Ensure that account balances reflected on the monthly LGS status report are reconciled to TAS for accuracy. Any differences should be communicated to the Law Department or LGS directly to ensure congruency of records between the agencies.

DCAS Response: DCAS generally agreed, stating: “DCAS is in the process of reconciling TAS and LGS records. In some instances, TAS and LGS will not be the same because LGS only records amounts where money judgments have been issued as a result of a court proceeding. TAS records the full arrears amount.”

5. Ensure that all payments and changes reflected in the collection agency’s monthly status report are appropriately recorded in TAS.

DCAS Response: DCAS agreed, stating: “LGS reports have been reviewed and TAS has been updated to reflect all collection received. DCAS will record any collections as reported by LGS in its monthly reports.”

Lack of Formalized Write-off Policies

DRES is prudent in writing off accounts deemed uncollectible and obtains required approvals and authorizations prior to making the write-offs, in compliance with Comptroller's Directive #21. However, it lacks formalized write-off policies, which are also required by the Directive.

Between 2005 and 2007, DRES wrote off a little more than \$2 million for 119 accounts with rent arrears deemed uncollectible. Overall, these write-offs represent 1.3 percent of total rent collections of \$159.9 million for Fiscal Years 2005 through 2007. On average, the accounts were 8.4 years old (aged from the account termination date) at the time of write-off. DRES obtained the necessary approvals (i.e., the Commissioner or the Comptroller's Office) for all of these write-offs.

In comparison, as of July 1, 2007, there were 162 terminated accounts on DRES records with a balance of \$9.9 million that had been transmitted to the Law Department for further collection proceedings. Of the previously discussed 150 accounts with measurable dates, additional analysis of the age of the cases as of July 1, 2007, determined that 79 of the 150 cases, which were referred to the Law Department from 1987 through 2002, averaged between 10.1 years old and 17.0 years old (calculated from the termination date) and had arrears totaling \$8.7 million (94%) of the \$9.2 million in arrears for the 150 accounts as of July 1, 2007. The arrears for all of these accounts remained outstanding on DRES records as of July 1, 2007.

Based on the age and low collection rate of accounts transferred to the Law Department, the likelihood of recouping payment on these arrears is remote at best. However, because DCAS does not have a formal write-off policy for its own operations, cases for which both internal and external collection efforts have been exhausted and for which continued efforts are no longer cost effective are not consistently written off.

Recommendations

DRES should:

6. Develop formal write-off policies consistent with its operations.

DCAS Response: DCAS agreed, stating: "We have developed formal write-off policies that are available for examination by the auditors."

7. Review the current cases transmitted to the Law Department to determine whether any should be considered for writing off.

DCAS Response: DCAS generally agreed, stating: "Past practice had been to periodically review with the Law Department previously referred terminated accounts. On a quarterly basis, DCAS will now review the list of accounts referred to the Law Department to identify those that can be written off. Accounts referred to the Law Department's collection agency that have been terminated for three years or more will be written off."

Other Matters

Arrear Report Error

Based on our reconciliation of the monthly billing and cash receipts amounts for Fiscal Years 2005 through 2007 to the monthly arrears reports, we identified an error in totals printed on the reports. However, these errors did not affect the data in TAS. Instead, the problem was in the program code for reporting total accumulation that resulted in a double counting of certain transaction codes. We brought this matter to the attention of DRES officials and learned that the Director of the Financial Services Bureau was aware of the problem and that manual reconciliation of the reports was being performed monthly. Upon further meetings with DRES officials, we were advised that the report “glitch” was being resolved and had no affect on the individual accounts in TAS.

Appendix

Accounts with Rent Arrears as of July 1, 2007

Account Status/ Stratification Group	Number of Cases (a)	Total Arrears (b)	Number of Sampled Cases (c)	Percent of Total Cases (c÷a)	Total Arrears of Sampled Cases (d)	Percent of Total Arrears (d÷b)
ACTIVE ACCOUNTS-TENANTS IN POSSESSION OF PROPERTY						
Lease Accounts in Arrears over 60 days as of 7/1/2007	14	\$165,826	14*	100%	\$165,826	100%
Accounts in Arrears Under 60 Days(as of 7/1/2007)	43	\$482,135	43**	100%	\$482,135	100%
Chung-Pak Walker Street Local Development Corp.- Being handled by the Law Department	2	\$15,288,113	2*	100%	\$15,288,113	100%
Accounts with Administrative Hold	3	\$1,761,479	1*	33%	\$1,365,000	77%
Accounts with Hold-Over Proceedings	8	\$58,421	2*	25%	\$48,912	84%
Accounts in Arrears for which legal proceedings have been initiated	6	\$277,278	2**	33%	\$78,702	28%
Other (i.e., lease accounts involving government agencies, watershed and bungalow properties)	29	\$65,978	<i>Not Tested</i>			
Total of Active Accounts and Arrears	105	\$18,099,230	64	61%	\$17,428,688	96%
TERMINATED ACCOUNTS- DCAS TOOK POSSESSION OF PROPERTY						
Transferred to Law Department for further collection actions (i.e., outside collection agency)	162	\$9,855,623	8*	5%	\$993,007	10%
Tenant in Bankruptcy	7	\$277,003	1*	14%	\$156,066	56%
Handled by DCAS Legal Division (in-house)	15	\$349,622	2*	13%	\$140,151	40%
Accounts with one time debt pay back offer	4	\$36,331	1*	25%	\$17,514	48%
Handled by DRES Property Management & Leasing Unit	20	\$2,480,011	1*	5%	\$2,211,431	89%
Other	1	\$371	<i>Not Tested</i>			
Total Terminated Accounts and Arrears	209	\$12,998,961	13*	6%	\$3,518,169	27%
Grand Total -Accounts in Arrears 7/1/2007	314	\$31,098,190	77	24%	\$20,946,857	67%

Note: *Accounts for which account files (source documentation) and TAS data were reviewed.

**Accounts for which only TAS data were reviewed



DEPARTMENT OF CITYWIDE ADMINISTRATIVE SERVICES
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Martha K. Hirst
Commissioner

May 21, 2008

Citywide Personnel
Services

Facilities
Management &
Construction

Municipal Supply
Services

Real Estate Services

Citywide Equal
Employment
Opportunity

Citywide
Occupational Safety
& Health

Transportation
Services

The City Record

CityStore

John Graham
Deputy Comptroller
Audits, Accountancy & Contracts
Office of the Comptroller
1 Centre Street Room 530
New York, NY 10007

RE: Audit Report on the Department
of Citywide Administrative Services
Collection of Rent Arrears
MJ08-053A

Dear Mr. Graham:

We have reviewed the Draft Audit Report dated May 7, 2008. We have found the Report to be a fair assessment of the arrears collection process employed by the Division of Real Estate Services, and agree with the Report's conclusions. In particular, we are pleased to see that the Report finds that "DCAS maintains adequate efforts to collect rent arrears", and that "DRES actively pursues all available activities and efforts to encourage tenants and former tenants to pay their arrears."

With regard to the recommendations contained in the Report which pertain exclusively to collection of arrears for terminated accounts, and to write-off policies related to uncollectable rent arrears, we have already initiated or completed implementation of measures to address the Report's recommendations. Our responses to each of the Report recommendations are as follows:

1. Ensure that cases for which all internal collection efforts have been exhausted are transferred to the Law Department in a timely manner.

We agree. This has been incorporated into our written write-off policies.

2. Establish a benchmark (time period) for transmitting cases to the Law Department for collection and ensure compliance with this time frame so as to increase the likelihood of collection.

We agree. This has been incorporated into our written write-off policies.

3. Require that DRES establish ongoing communication with the Law Department to report on the status of accounts transferred for collection, especially those accounts that are not conveyed to the external collection agency.

Past DCAS practice had been to periodically review with the Law Department previously referred terminated accounts.

On a quarterly basis, DCAS will now review the list of accounts referred to the Law Department to identify those that can be written off. Accounts referred to the Law Department's collection agency that have been terminated for three years or more will be written off.

4. Ensure that account balances reflected on the monthly LGS status report are reconciled to TAS for accuracy. Any differences should be communicated to the Law Department or LGS directly to ensure congruency of records between the agencies.

DCAS is in the process of reconciling TAS and LGS records. In some instances, TAS and LGS will not be the same because LGS only records amounts where money judgments have been issued as a result of a court proceeding. TAS records the full arrears amount.

5. Ensure that all payments and changes reflected in the collection agency's monthly status report are appropriately recorded in TAS.

LGS reports have been reviewed and TAS has been updated to reflect all collections received. DCAS will record any new collections as reported by LGS in its monthly reports.

6. Develop formal write-off policies consistent with its operations.

We have developed formal write-off policies that are available for examination by the auditors.

7. Review the current cases transmitted to the Law Department to determine whether any should be considered for writing off.

See item #3 response.

Lastly, in the section of the Report titled *Public Health Research Institute (PHRI)* on Pages 12 and 13, reference is made to an email dated January 8, 2008 from Robin Green of the Law Department regarding the actual balance due on the account. The Report says that there is a "lack of certainty about the actual balance of PHRI's account" and raises a question as to whether a sale of stock in the amount of \$1,044,900 that occurred in 1996 was correctly recorded in TAS.

We have reviewed DCAS records and those of the Law Department. We have confirmed that the stock sale proceeds received by the City in the amount of \$1,044,900 were correctly recorded in TAS under account #31015 on December 12, 1996. This account was established specifically to post proceeds received from the stock sale against arrears owed by PHRI pursuant to a Stipulation of Settlement.

The resulting shortfall of \$655,100 between the anticipated stock sale proceeds of \$1.7 million and actual proceeds was then transferred to a new TAS account #31016 and added to the \$1.7 million of contingency revenue receivable from patent royalty income, resulting in a total balance of \$2,355,100. As of May 16, 2008 the City has received \$181,199 in such royalty payments, resulting in a current contingency receivable balance of \$2,173,901, as is currently reflected on TAS.

We thank the Auditors for their efforts on this Audit.

Sincerely,



Martha K. Hirst

C: Lori Fierstein
Ilene Lecs
Donald Brosen
Barry Gendelman
Christopher Lane