CITY OF NEW YORK
OFFICE OF THE COMPTROLLER

John C. Liu
COMPTROLLER

FINANCIAL AUDIT

Tina Kim
Deputy Comptroller for Audit

Audit Report on the Compliance of MDO Development Corporation With Its Lease Agreement

FM10-126A

February 9, 2011

http://comptroller.nyc.gov

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET ROOM 1100
NEW YORK, N.Y. 10007-2341

John C. Liu
COMPTROLLER

TINA KIM
DEPUTY COMPTROLLER
BUREAU OF AUDITS

TELEPHONE: (212) 669-8459
FAX NUMBER: (212) 815-8559
WWW.COMPTROLLER.NYC.GOV

EMAIL: TKIM@COMPTROLLER.NYC.GOV

February 9, 2011

To the Residents of the City of New York:

My office has audited the compliance of MDO Development Corporation (MDO) with its lease agreement with the Department of Small Business Services (DSBS). The Economic Development Corporation (EDC) administers the terms of the agreement with MDO on behalf of DSBS. We audit entities such as MDO as a means of ensuring that they comply with the terms of their agreements.

Under the amended lease agreement, MDO is required to pay the greater of an annual fixed rent or percentage rent for operating a restaurant, d/b/a The Water Club, located along the East River between 30th Street and 32nd Street in Manhattan. For calendar year 2009, annual fixed rent was $495,000 and the percentage rent was 6 percent of $10,500,000 or less in gross receipts, plus 7 percent of gross receipts in excess of $10,500,000. In addition, MDO is to maintain a security deposit of $50,000 with the City, pay all utilities charges, maintain proper insurance coverage, expend $450,000 on tenant improvements within two years of the amended lease's commencement date, and submit quarterly income statements and a certified annual income statement with a reconciliation of income reported to the City.

The audit found that MDO maintained the required insurance coverage that named the City and EDC as additional insured parties, maintained the required security deposit, and paid all utilities charges. However, weaknesses in MDO's control procedures prevented the auditors from determining whether MDO accurately reported all of its gross receipts from its restaurant and banquet operations and whether it paid the appropriate fees to the City. Although MDO has sufficient controls over the recording of revenue from food and beverages purchased within the dining room, its controls over the bar operation and the Crow's Nest (the outdoor dining area) need to be enhanced to ensure that all gross receipts derived from beverage sales are properly recorded and reported to the City. The auditors found that MDO staff circumvented its procedures by entering an excessive number of "No-Sale" transactions and by cancelling orders entered in their point of sale (POS) system. Since bar and Crow's Nest revenue is reported as sales from its restaurant operation, it is reasonable to conclude that gross receipts were not accurately reported, and thus the auditors could not determine if any additional rent is due the City.

In addition, the auditors were not able to determine whether MDO expended at least $450,000 on tenant improvements because MDO did not provide sufficient documentation to support the expenditures. Further, EDC did not provide adequate oversight to ensure that MDO complied with the terms and conditions of the lease agreement. Thus, the audit recommends that MDO take immediate action to strengthen its financial controls; complete all required tenant improvements as required under Article 18 of the lease agreement; and submit to EDC documentation supporting the completion of specific tenant improvements and the actual amount spent.

The results of the audit have been discussed with MDO and EDC officials, and their comments have been considered in preparing this report. Their complete written responses are attached to this report. If you have any questions concerning this report, please e-mail my audit bureau at audit@comptroller.nyc.gov.

Sincerely,

John C. Liu

Table of Contents

The City of New York
Office of the Comptroller
Financial Audit

Audit Report on the Compliance of MDO Development Corporation With Its Lease Agreement

FM10-126A

AUDIT REPORT IN BRIEF

This audit determined whether MDO Development Corporation (MDO) properly reported its gross receipts, correctly calculated and paid its rent due the City, and complied with certain non-revenue terms of the lease agreement.

On October 4, 1979, the City of New York (City), entered into a 25-year lease agreement with MDO to construct and operate a restaurant located along the East River between 30th Street and 32nd Street in Manhattan. On December 30, 2001, the City, through the Department of Small Business Services (DSBS), amended the lease agreement with MDO and extended the term to August 31, 2030. The Economic Development Corporation (EDC) administers the terms of the agreement with MDO on behalf of DSBS.

Under the amended lease agreement, MDO is required to pay the greater of an annual fixed rent or percentage rent. For calendar year 2009, annual fixed rent was $495,000 and the percentage rent was 6 percent of $10,500,000 or less in gross receipts, plus 7 percent of gross receipts in excess of $10,500,000. The agreement allows certain exclusions (e.g., commissions paid to third parties) from the gross receipts.

In addition, MDO is to maintain a security deposit of $50,000 with the City, pay all utilities charges, maintain proper insurance coverage, expend $450,000 on tenant improvements within two years of the amended lease's commencement date, and submit quarterly income statements and a certified annual income statement with a reconciliation of income reported to the City.

For calendar year 2009, MDO reported $6,190,181 in gross receipts and paid the City $495,000 in fixed rent and $4,142 in late charges.

Audit Findings and Conclusions

MDO maintained the required insurance coverage that named the City and EDC as additional insured parties, maintained the required security deposit, and paid all utilities charges.

However, weaknesses in MDO's control procedures prevented us from determining whether MDO accurately reported all of its gross receipts from its restaurant and banquet operations and whether it paid the appropriate fees to the City. Although MDO has sufficient controls over the recording of revenue from food and beverages purchased within the dining room, its controls over the bar operation and the Crow's Nest (the outdoor dining area) need to be enhanced to ensure that all gross receipts derived from beverage sales are properly recorded and reported to the City. We found that MDO staff circumvented its procedures by entering an excessive number of "No-Sale" transactions and by cancelling orders entered in their point of sale (POS) system. Since bar and Crow's Nest revenue is reported as sales from its restaurant operation, it is reasonable to conclude that gross receipts were not accurately reported, and thus we could not determine if any additional rent is due the City. In addition, we were not able to determine whether MDO expended at least $450,000 on tenant improvements because MDO did not provide sufficient documentation to support the expenditures.

Audit Recommendations

We make eight recommendations—three to MDO concerning the operation of the restaurant and five to EDC concerning the oversight of this concession. Below are some of the recommendations.

MDO should:

- Take immediate action to strengthen its financial controls.
- Complete all required tenant improvements as required under Article 18 of the lease agreement.
- Submit to EDC complete documentation supporting the completion of specific tenant improvements and the actual amount spent.

EDC should:

- Ensure that MDO implements the proper controls necessary to address the deficiencies cited in this report.
- Periodically monitor MDO to ensure that MDO maintains proper financial controls, that all receipts are recorded on MDO's books and records and on reports submitted to EDC. If MDO refuses to implement or maintain the proper controls, EDC should immediately inform the Department of Small Business Services so that it may consider terminating its lease agreement with MDO.

- Perform a thorough review of the documentation and improvements to ensure that the improvements and associated costs meet the requirements of the contract.

Discussion of Audit Results

MDO and EDC officials generally agreed with the audit's findings and recommendations. However, MDO chose not to implement certain recommendations because it believes that several of its existing controls are sufficient. The full texts of the responses received from MDO and EDC are included as addenda to this report.

INTRODUCTION

Background

On October 4, 1979, the City entered into a 25-year lease agreement with MDO, d/b/a The Water Club, to construct and operate a restaurant located along the East River between 30th Street and 32nd Street in Manhattan. The restaurant occupies two floating barges and a two-story structure. On December 30, 2001, the City, through the DSBS, amended the lease agreement with MDO and extended the term to August 31, 2030. EDC administers the terms of the agreement with MDO on behalf of DSBS.

Under the amended lease agreement, MDO is required to pay the greater of an annual fixed rent or percentage rent. For calendar year 2009 (the eighth lease year), annual fixed rent was $495,000 (i.e., $41,250 per month) and the percentage rent was 6 percent of $10,500,000 or less in gross receipts, plus 7 percent of gross receipts in excess of $10,500,000. The agreement allows certain exclusions (e.g., commissions paid to third parties) from the gross receipts.

Fixed rent is due on the first of each month and estimated quarterly percentage rent (based on the actual gross receipts from the previous year) is due on February 15, May 15, August 15, and November 15. Actual percentage rent is to be calculated within 90 days after each lease year has ended and paid in the subsequent lease year. If rent is not paid within 10 days after the due date, a late charge of 24 percent per annum is assessed for the unpaid rent. In addition, MDO is to maintain a security deposit of $50,000 with the City, pay all utilities charges, maintain proper insurance coverage, and expend $450,000 on tenant improvements within two years of the amended lease's commencement date.

MDO is also required to submit quarterly income statements within 45 days after the end of each quarter and a certified annual income statement with a reconciliation of income reported to the City within 90 days after the end of each lease year.

For calendar year 2009, MDO reported $6,190,181 in gross receipts and paid the City $495,000 in fixed rent and $4,142 in late charges, as shown in Table I.

Table I

Schedule of Reported Gross Receipts
January 1, 2009, to December 31, 2009

Description	Amount
Food Gross Receipts	$4,446,176
Beverage Gross Receipts	1,664,375
Other Gross Receipts	180,867
Total Gross Receipts	$6,291,418
Less Allowable Exclusions:	
Credit Card Commissions	(99,134)
Broker Commissions	(2,103)
Total Exclusions	(101,237)
Reported Gross Receipts	**$6,190,181**
Base Rent Paid	$495,000
Late Charges Paid	4,142
Total Payments	**$499,142**

Objectives

The audit's objectives were to determine whether MDO:

- Properly reported its gross receipts and correctly calculated and paid its rent due the City, and

- Complied with certain non-revenue terms of the lease agreement (i.e., maintaining the required security deposit, carrying the required insurance, submitting the required reports, paying for all utility charges, and expending $450,000 in tenant improvements).

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives except for the inability of MDO to provide sufficient evidential matter that would allow us to determine whether MDO accurately reported all of its gross receipts and whether it paid the appropriate fees to the City. MDO also did not provide sufficient documentation that would allow us to determine whether MDO expended the required amounts of $450,000 on tenant improvements. These issues are fully disclosed in the Findings section of this report. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit was calendar year 2009. To achieve our audit objectives, we reviewed and abstracted the lease agreement between the City and MDO. We also reviewed prior audit reports, quarterly income statements, certified annual income statements, audited financial statements, and other relevant documents. We analyzed EDC's Tenant History MRI Live ledger for the rents reported and paid to the City and determined whether payments were received on time for calendar year 2009. We also determined whether MDO submitted quarterly income statements and certified annual income statements to EDC in a timely manner. To test the accuracy of the certified annual income statement that MDO submitted to EDC for calendar year 2009, we reconciled the revenue and allowable deductions that were recorded in MDO's general ledger with the amounts in the certified annual income statement.

To obtain an understanding of MDO's operations and internal controls over its gross receipts, we

- Interviewed relevant MDO personnel (i.e., MDO's general manager and captain for the restaurant, controller, accountant, Director of Private Events, and Public Relations Manager);

- Reviewed the manual for use of the restaurant's POS system (MICROS);

- Conducted a walk-through of the restaurant and banquet operations;

- Observed restaurant staff processing transactions through MICROS POS system on March 10, 2010;

- Conducted three unannounced observations of its restaurant operation and one unannounced observation of its banquet reservation process in February 2010;

- Conducted six unannounced observations of the Crow's Nest's operation in June 2010 and July 2010[1]; and

- Documented our understanding of the operations through written narratives, memoranda, and flow charts.

MDO uses the MICROS POS computer system to manage its restaurant operation and records the proceeds collected from the restaurant sales and credit card payments for banquet events and gift certificates sales. To determine the accuracy, completeness, and reliability of the reports generated from MICROS POS system, we judgmentally selected February 2, 2010, and February 24, 2010, (the days auditors conducted the unannounced observations of MDO's restaurant operation) and compared the guest checks information obtained during the

[1] The Crow's Nest is a seasonal outdoor dining area, which operates from mid-May to late September on the outer deck of The Water Club.

unannounced observations to the list of closed (processed and paid) guest checks. We then traced the sales information from all of the actual guest checks to the lists of closed guest checks and then to the MICROS POS System Financial Reports and a la carte sales journal. In addition, we tested the MICROS POS system on March 10, 2010, by purchasing a beverage from each of the four MICROS POS terminals in the dining room and bar. To determine whether the MICROS POS terminals generated consecutive guest check numbers and the transactions were properly and accurately recorded, we matched the actual guest checks obtained during our test with the MICROS POS list of closed guest checks.

To determine whether MDO properly recorded its dining room and bar gross receipts, we judgmentally selected the two weeks (February 1-7, 2010, and February 22-28, 2010) that included the dates we conducted our unannounced observations (i.e., February 2, 2010, and February 24, 2010), and traced the daily sales from MICROS POS System Financial Reports to the a la carte sales journal. We then traced the February 2010 restaurant sales from a la carte sales journal to the general ledger.[2]

To ascertain whether transactions are properly and accurately recorded in MICROS POS at the Crow's Nest, we compared our food and beverages consumptions during our six unannounced observations to the MICROS POS reports (lists of closed guest checks for June 23, 2010, June 27, 2010, June 30, 2010, and July 1, 2010, and MICROS POS journals for July 1, 2010). We also analyzed all the transactions, including food and beverage sales, canceled, and "No Sale" transactions, entered at the Crow's Nest on July 1, 2010, and viewed surveillance footage. Due to the limitations of the data available from the MDO POS (data was not available for more than two days), we were only able to review records for July 1, 2010.

To determine whether MDO properly recorded its gross receipts in calendar year 2009, we judgmentally selected as our sample June 2009, the month with the highest percentage decrease of its total revenue from previous year. We traced the daily total restaurant sales from MICROS POS System Financial Reports to the a la carte sales journal. We also reviewed the banquet files and traced the banquet revenue to the banquet sales journals. To determine whether MDO accurately recorded the banquet payments received in June 2009, we traced all banquet payments recorded in the general ledger to the individual banquet event accounts. We then traced the monthly sales amounts from the a la carte and banquet sales journals to the general ledger. In addition, we reviewed the cash receipts journal to identify unusual transactions and traced the cash receipts from the MICROS POS Cashier Financial Reports to Cash Sales/Drop Reconciliation Sheet and deposit slips, and then to bank statements. To determine whether the credit card charges were properly deposited to MDO's bank accounts, we traced the credit card charges from the daily MICROS POS Credit Card reports to the credit card statements and cash receipts journal, and then to the bank statements.

We also compared the banquet events listed on the 2009 banquet event calendar and the banquet sales journals to ascertain whether all banquet events were properly recorded. In addition, we reviewed the deferred income accounts to determine whether proceeds received

[2] MDO uses commercial-off-the-shelf software: Lotus 1-2-3 to manually record a la carte and banquet sales journals, and QuickBooks to maintain individual accounts for banquet events and its general ledger.

from the banquet events were properly recorded in the general ledger. Last, we reviewed all the house account transactions to determine whether MDO properly reported these sales.

To ascertain whether banquet gratuities were fully distributed to MDO's employees in accordance with Labor Law §196-d, Division of Labor Standards, New York State Department of Labor, we traced banquet gratuities collected from the June 2009 events to MDO's payroll records.

Finally, we determined whether MDO complied with certain non-revenue terms of its agreement (i.e., maintained the required security deposit, carried the required insurance, paid for all utility charges, and expended $450,000 in tenant improvements). We contacted EDC to determine whether the amount of the required security deposit posted with the City met the requirements of the agreement. In addition, we obtained MDO's insurance policies and contacted the insurance broker to determine whether MDO maintained proper insurance coverage. We reviewed MDO's electric, gas, and water and sewer bills for calendar year 2009 to determine whether MDO paid all utility charges. We also obtained supporting documentation and correspondence from EDC to determine whether MDO expended $450,000 in tenant improvements.

Discussion of Audit Results

The matters covered in this report were discussed with MDO and EDC officials during and at the conclusion of this audit. A preliminary draft report was sent to these officials and discussed at an exit conference on November 23, 2010. On December 10, 2010, we submitted a draft report to MDO and EDC officials with a request for comments. On December 21, 2010, and December 27, 2010, we received written responses from EDC and MDO officials, respectively.

EDC and MDO officials generally agreed with the audit's findings and recommendations. However, MDO chose not to implement certain recommendations because it believes that several of its existing controls are sufficient. The full text of the responses received from MDO and EDC are included as addenda to this report.

FINDINGS

MDO maintained the required insurance coverage that named the City and EDC as additional insured parties, maintained the required security deposit of $50,000, and paid all utilities charges (i.e., electricity, gas, and water and sewer).

However, weaknesses in MDO's control procedures prevented us from determining whether MDO accurately reported all of its gross receipts from its restaurant and banquet operations and whether it paid the appropriate fees to the City. Although MDO has sufficient controls over the recording of revenue from food and beverages purchased within the dining room, its controls over the bar operation and the Crow's Nest need to be enhanced to ensure that all gross receipts derived from beverage sales are properly recorded and reported to the City. We found that MDO staff circumvented its procedures by entering an excessive number of "No-Sale" transactions and by cancelling orders entered in the MICROS POS system. Since bar and Crow's Nest revenue is reported as sales from its restaurant operation, it is reasonable to conclude that gross receipts were not accurately reported, and thus we could not determine if any additional rent is due the City. In addition, we were not able to determine whether MDO expended at least $450,000 on tenant improvements because MDO did not provide sufficient documentation to support the expenditures.

Control Weaknesses over Restaurant Operation

Although MDO has sufficient controls over the recording of revenue from food and beverages purchased within the dining room, its controls over the bar operation and the Crow's Nest need to be enhanced to ensure that all gross receipts derived from beverage sales are properly recorded and reported to the City. We found that MDO staff circumvented its procedures by entering an excessive number of "No-Sale" transactions and by cancelling orders entered in the MICROS POS system. Since bar and Crow's Nest revenue is reported as sales from its restaurant operation, it is reasonable to conclude that gross receipts were not accurately reported, and thus we could not determine if any additional rent is due the City.

During our six unannounced observations at the Crow's Nest in June and July 2010 (June 23, 27, and 30, 2010, and July 1, 2010), the audit teams (each audit team contains two auditors) wrote down the food and beverages consumed, the amount charged by the Crow's Nest wait staff, time that the orders were placed, the amount paid (all of our purchases were paid in cash), and the information on guest checks, if available. We then compared the sales information to the MICROS POS lists of closed guest checks and journals.[3] Ten of the 22 orders (45.5 percent) or $138.50 of the $371.76 (37.3 percent) paid by the auditors were not recorded in MICROS POS system. For example, on July 1, 2010, our auditors ordered two beverages at 5:57 p.m., gave the bartender a $20 bill, and received $6 in change. However, we were not able to find a record of the two beverages on the MICROS POS list of closed guest checks; instead, we found that a canceled guest check #7617 was opened and closed at 5:58 p.m.

[3] On July 2, 2010, we requested that MDO provide MICROS POS journals for the dates we conducted our unannounced observations. However, MDO officials informed us that the MICROS POS system maintains journal data for just two days, and could therefore provide us with the journal data for only July 1, 2010.

Moreover, we observed that the Crow's Nest wait staff regularly used the No-Sale function to open the cash drawer when customers paid for their orders with cash. Tables II and III below show the inordinate number of guest checks canceled and the number of transactions for which the No-Sale was used during the four days of our unannounced observations:

Table II

Schedule of Cancelled Crow's Nest Guest Checks

Date	Total Number of Guest Check Generated	Number of Guest Checks with Sales	Number of Canceled Guest Checks	Percent of Canceled Guest Checks
June 23, 2010	50	41	9	18%
June 27, 2010	61	58	3	5%
June 30, 2010	90	78	12	13%
July 1, 2010	57	51	6	11%
Total	**258**	**228**	**30**	**12%**

Table III

Frequency of No-Sale Transactions
Occurring at the Crow's Nest

Date	Total Number of Guest Checks Generated	Number of Times that No-Sale Function was used	Ratio of Number of Guest Checks for Each Time No-Sale Function was Used
June 23, 2010	50	13	4:1
June 27, 2010	61	15	4:1
June 30, 2010	90	23	4:1
July 1, 2010	57	20	3:1
Total	**258**	**71**	**4:1**

For every four guest checks processed at the Crow's Nest, MDO processed one No-Sale transaction. The high volume of canceled guest checks and No-Sale transactions clearly indicates the probability that all transactions are not being processed through the MICROS POS system and all revenue is not being reported. In addition, our review of the MICROS POS Employee Financial Reports found that for calendar year 2009, bartenders used the No-Sale function 6,445 times; however, they generated only 10,243 guest checks.[4] In other words, there was a No-Sale transaction used for every one and a half guest checks generated.

[4] These 10,243 guest checks also include canceled checks. The data obtained from the MICROS POS system did not separate the number of canceled guest checks from the total number of guest checks generated.

In addition to the unannounced observations at the Crow's Nest, there was another questionable transaction that could indicate that cash proceeds collected at the bar may not be accurately recorded in the POS system. On March 10, 2010, we tested MDO's POS system by purchasing one beverage at each of the four terminals in the restaurant: three at dining rooms and one at the bar. Since the POS terminal at the bar included the only cash drawer, which is used to handle all cash transactions, we made all four payments at the bar POS terminal. Subsequently, we reviewed the MICROS POS reports and found that one of the four orders was voided in the POS system. However, we could not determine how the cash related to this void transaction was accounted for.

Furthermore, our review of the restaurant operation identified other internal control weaknesses within MDO's restaurant operation.

- MDO does not maintain journals for more than two days. According to the MICROS POS system manual, "A journal is a record of every transaction throughout the System. This provides a trail of activity that is independent of hard copies of guest checks, validation slips, etc." Contrary to §4.01(b)(ix) and §26.02(a) of the lease agreement, MDO is required to maintain all sales records for at least four years.

- The data available from the MICROS POS system does not appear to be reliable for audit purposes. We noted issues with sales and guest check information and could not determine whether the POS summary reports included all the sales transactions. For example, the MICROS POS System Financial Report for February 2, 2010, indicated that 91 guest checks were generated, but the MICROS POS system's list of closed guest checks contained 95 guest checks—a discrepancy of four checks. We also found that the MICROS POS system's list of closed guest checks did not always contain certain miscellaneous charges for upgrades to meal orders or beverages.

- MDO does not assign individual access codes to its employees who operate the MICROS POS system. By not assigning individual access codes to the employees, management is unable to identify which employee entered or changed an order in the MICROS POS system.

- MDO does not use press printed and pre-numbered gift certificates. Press printed and pre-numbered documents are a basic internal control that allows management and auditors to account for all the sales and redemption of the gift certificates.

Adequate control systems are necessary for properly tracing receipts from the point of sale to their being recorded in an organization's books and records, and finally to their being reported to the City. Without proper internal controls in place, EDC cannot be assured that all revenue from MDO's restaurant operation is being accurately reported and that the City is receiving its fair share of rent.

Control Weaknesses over Banquet Operation

MDO does not have adequate control procedures over its banquet operation to ensure that all gross receipts are properly recorded and reported to the City. Specifically, MDO does not use pre-numbered banquet contracts. In the absence of pre-numbered contracts, we cannot be assured that all revenue from banquet activity was recorded on MDO's books and reported to the City and that appropriate rent was paid to the City. The same condition was cited in our prior audit report *Audit Report on Rent Due from MDO Development Corporation d.b.a. The Water Club and Compliance with its Lease Agreement January 1, 1986, to June 30, 1991*, dated September 11, 1992. In that report, MDO responded that it intended to use pre-numbered banquet contracts in the near future. However, as of April 2010—more than 17 years later—MDO still manually assigns banquet contract numbers to the banquet contracts.

Moreover, MDO does not record the banquet sales in the POS system as required by the lease agreement and does not maintain a permanent record of initial intake of all funds received in conjunction with banquets that identifies, by date received, payers' names, amounts, form of payment (i.e., cash or checks) and a description of what the payment is for. MDO also does not maintain evidence that payment receipts were issued to banquet customers who paid by cash or check or does not record in the POS system the banquet deposits, except for credit card payments.

The lack of proper recording procedures, in addition to the use of manual recording system, provides opportunities to circumvent the accurate reporting of gross receipts. However, the creation of a permanent record of funds enhances the audit trail and further ensures that banquet receipts are properly accounted for.

MDO Did Not Provide Sufficient Documents to Support the Amount Spent on Tenant Improvements

MDO did not comply with the lease agreement's requirement to expend at least $450,000 in tenant improvements within two years of the lease's commencement date. Based on the documentation provided, we were unable to substantiate the $527,939 that MDO claimed it had spent on tenant improvements. The supporting documents provided (e.g., invoices) were either without detailed descriptions for the work performed or not related to the improvements required by the lease agreement.

Specifically, §18.03 of the lease agreement states that "Tenant shall submit to Landlord, upon Landlord's request, true and complete copies of all invoices, cancelled checks, receipts and any other evidence of the costs incurred by Tenant in the construction of the Required Tenant Improvements."

Furthermore, on June 18, 2010, a member of the Comptroller's Office engineering audit group inspected the Water Club to determine whether MDO completed the required improvements, but the engineer concluded that there was inconclusive evidence that the concessionaire expended any required funds to make the improvements noted in lease agreement.

EDC also had difficulties in obtaining supporting documents from MDO. Our review of the correspondence between MDO and EDC indicated that from 2004 to 2008, EDC repeatedly asked MDO to provide evidence that MDO had expended a minimum of $450,000 in tenant improvements, but as of July 26, 2010, MDO had not submitted sufficient documentation to support the amount spent on tenant improvements. Therefore, we were unable to determine the actual amount spent on tenant improvements and whether all the tenant improvements were completed.

RECOMMENDATIONS

MDO should:

1. Take immediate action to strengthen its financial controls, including but not limited to the following:

    - Ensure that all financial transactions from restaurant and banquet operations are accurately recorded in a point-of-sale system.

MDO Response: "The Water Club utilizes the MICROS Point of Sale System to control its ala carte restaurant and the flow of food and beverage from its kitchen and bars. It is also used to track and reconcile the daily cash and credit card receipts of the ala carte operation.

"The banquet credit card payments are regularly entered in the Micros system as it is the only method to facilitate collection of funds from our credit card processor. Most of the banquet payments are received in the form of personal checks or wire transfers. A very, very small percentage of banquet payments are received as currency. Any and all payments are recorded in banquet department party folder and forwarded to the accounting office for inclusion in the accounting and general ledger records."

- Maintain all source documents, e.g., point-of-sale system reports and sales data, and the journals, for at least four years to support the gross receipts reported to the City.

MDO Response: "Ala Carte documents are currently maintained in electronic form permanently on accounting office computers. At your request, the Journal Reports will be added to the daily download and storage reports. These journals will also be maintained permanently. Physical guest checks are maintained for six months to allow for credit card inquiries by customers."

- Segregate the responsibilities of receipts and reconciliation at the bar and Crow's Nest. Institute reconciliation and control procedures to ensure all transactions are properly recorded and supported.

MDO Response: "A daily Cashier Report is prepared by each bartender. The report details cash taken in and payouts for gratuities and other items. The report is sent to the accounting office for reconciliation with the point of sale system. Very small differences are noted but more significant differences are investigated. The cashier reconciliation is an integral part of the daily accounting reconciliation of restaurant sales. To ensure the integrity of the bar staff, we have and will continue to conduct spot integrity checks and tests. If we found a dishonest bartender, which is endemic to this business, we would terminate them."

- Reposition the surveillance cameras so that POS screens can be monitored to ensure that transactions are correctly entered into the POS system.

MDO Response: "The surveillance systems were installed to observe the proper procedures of the staff and insure the safety of company and customer personnel and property and to prevent false customer claims. The system is currently operating at maximum capacity. At the next upgrade, we will install a comprehensive system capable of more closely observing cash register transactions as you suggest."

- Perform periodic reasonableness tests by tracking the number of No-Sale transactions and canceled guest checks. Monitor the number of questionable transactions for frequency and fluctuations from period to period.

MDO Response: "The restaurant management and office staff have been made more aware of questionable transactions and cash drawer openings outside of the norm. The cash drawer function has been restricted and requires management intervention outside of regular transactions."

- Assign individual access codes to those employees who operate the POS system.

MDO Response: "The restaurant service staff operates on a team basis. The purpose of the team concept is to afford maximum satisfaction to the customer. There is a captain, middle waiter, back waiter and bus person. Each person services the table and enters food and beverage items on the check as required. Customer checks are assigned to one individual by our point of sale system. Individual access codes would unnecessarily complicate service as they would not easily grant check access to other members of the team. The captain is the team leader who is responsible for all transactions relating to his assigned tables.

"The same concept is used at the bar and also at the Crows Nest which accounts for about 4% of total sales. The deck floor manager is responsible at the Crow's Nest. Restricting the access to a customer's check to one individual would not be conducive to good customer service. Many times during service, a waiter leaves the floor to retrieve food from the main kitchen or higher end wine from the dining room storage area. Several members of the floor staff service the table. We currently assign Micros access codes on a team basis and will continue to hold the floor manager responsible for errors. Bartenders are identified by the daily cashiers report and only the bartender and floor manger have access to the cash drawer."

- Use press-printed pre-numbered gift certificates, issue certificates in sequence and ensure that all transactions are recorded in the POS system.

MDO Response: "Gift certificates are currently consecutively numbered and maintained in a Gift Certificate Log book. We will use pre-printed and pre-numbered gift certificate stationary in the near future."

- Use banquet reservation software that can record, track, and reconcile all banquet reservations and payments, and can issue sequential banquet contracts and invoices. However, if MDO decides not to use banquet reservation software, MDO must:

- Use press-printed pre-numbered banquet contracts and issue contracts in sequence.

MDO Response: "Several years ago we explored banquet reservation software and decided to retain our current system. The systems that we observed did not suit our needs nor did they afford any increase in control over our current system.

"We will use pre-printed and pre-numbered stationery to assign consecutive numbers to our banquet contracts as suggested."

- Maintain a permanent record of initial intake of all funds received in conjunction with banquets that identifies, by date received, payers' names, amounts, form of payment, and a description of what the payment is for, and

- Issue press printed pre-numbered payment receipts for each banquet deposit payment, enter all financial transactions into the POS system, and maintain a copy of the payment receipt with the banquet contract in the banquet file."

MDO Response: "We will continue our practice of recording these consecutively numbered banquet contracts in our contract log. A permanent record of banquet payments is currently maintained and recorded in our general ledger system. We will continue maintaining our 'Banquet Transmittal' of all forms of payment as suggested. Receipts are currently prepared for all cash payments and issued to the customer. The receipts will be pre-printed and pre-numbered as suggested. Copies of the receipts and customer checks will continue to be maintained in the individual banquet files.

"Financial transactions relating to customer banquets are currently entered into the general ledger in detail. Each party is assigned a unique account number which combines the date of the function and the contract number. All financial data relating to the party is recorded in this account. Each progress payment, the final bill and any final payment or refund is maintained as part of the company's permanent accounting records. This system facilitates management reporting and individual accounts receivable statements and balances. It affords a high level of accounting integrity."

Auditor Comment**:** Our report concludes that MDO does not have sufficient controls in place that would provide the City with the assurance that all gross receipts are properly recorded and reported to the City. In fact, §4.01(ix) of the lease requires that MDO prepare, keep, and maintain complete and accurate books and records and that it record all sales, at the time each sale is made, whether for cash or credit, in a cash register or registers containing locked-in cumulative tapes with cumulation capacity satisfactory to the City. Clearly, the intent of the lease was to provide the City, not MDO, with the assurance that all sales are properly recorded and reported to the City.

To simply state that banquet reservation software does not suit their needs nor would afford any increase in control does not satisfy the City's assurance that all revenue is being recorded on MDO's books and records. Although MDO does describe certain actions it plans to take, we question MDO's seriousness in implementing the necessary controls because it did not provide a specific timetable when these controls will be implemented.

Unless EDC closely monitors MDO's action and ensures that MDO take the necessary corrective action and implements stronger internal controls called for in this report, the City cannot be assured that all revenue received by MDO is being recorded on MDO's books and records.

2. Complete all required tenant improvements as required under Article 18 of the lease agreement.

MDO Response: "The tenant improvements were completed as required and details were made available to the auditors. We received no comments on our submission other than in this report."

***Auditor Comment*:** We believe that MDO's contention that improvements were completed as required is misleading. In fact, our observations of the premises found that although some improvements were made to the restaurant's exterior and footprint, little if any improvements were made to the "esplanade" or public walkway between the restaurant and the 34th Street heliport. However, these improvements fall far short of the expected $450,000 required by the lease. In fact, §18.03(vii) of the lease states that as part of the Tenant Improvements, MDO is required to develop a landscape plan for the Premises and public walkway and implement the plan after consultation with Community Board 6. The plan will include refurbishing the esplanade area, including repainting pavement markers for parking stalls, replacing and redesigning deteriorated concrete or wood planters and wood seating, and improving lighting.

Moreover, on November 30, 2010, seven days after discussing with MDO its non-compliance to expend at least $450,000 in tenant improvements and nearly seven years after the date tenant improvements were to be completed, we observed MDO staff repairing the wood planters and seating area within the public area. Clearly, the required tenant improvements were not completed as required. Nonetheless, EDC has assured us that it will meet with MDO to develop a plan to complete the tenant improvements as required under the lease.

3. Submit to EDC complete documentation supporting the completion of specific improvements and the actual amount spent.

MDO Response: "We will resubmit the documentation to EDC for their review as suggested."

EDC should:

4. Ensure that MDO implements the proper controls necessary to address the deficiencies cited in this report.

EDC Response: "NYCEDC Agrees. NYCEDC will work with MDO to ensure that MDO utilizes proper controls to accurately record gross receipts."

5. Periodically monitor MDO to ensure that MDO maintains proper financial controls, that all receipts are recorded on MDO's books and records and on reports submitted to EDC. If MDO refuses to implement or maintain the proper controls, EDC should immediately inform the Department of Small Business Services so that it may consider terminating its lease agreement with MDO.

EDC Response: "NYCEDC partially agrees. NYCEDC agrees to monitor MDO periodically to ensure that proper controls are utilized and complete and accurate financial statements are submitted to NYCEDC. NYCEDC does and will continue to keep the Department of Small Business Services informed of MDO's compliance with the terms of the Lease."

6. Coordinate with MDO and develop a plan to complete the tenant improvements as required under Article 18 in the lease agreement.

EDC Response: "NYCEDC agrees. NYCEDC will meet with MDO to develop a plan to complete the tenant improvements as required under the lease."

7. Ensure that MDO completes tenant improvements as planned and submits complete documentation supporting the costs associated with the improvements.

EDC Response: "NYCEDC agrees. NYCEDC will continue to enforce the Lease and ensure that MDO complies with the plan to complete the required tenant improvements and submits documentation to support the associated costs."

8. Perform a thorough review of the documentation and improvements to ensure that the tenant improvements and associated costs meet the requirements of the contract.

EDC Response: "NYCEDC agrees. NYCEDC will ensure that all completed tenant improvements meet the requirements under the Lease."

MDO DEVELOPMENT CORPORATION

500 East 30th Street
New York, NY 10016

Ms. Tina Kim
Office of the Comptroller
The City of New York
One Centre Street - Room 1100
New York, NY 10007-2341

December 27, 2010

Dear Ms. Kim:

We are submitting our comments on the audit report dated December 10, 2010. The active audit was conducted by your staff in our offices from early March 2010 through July 3, 2010.

The audit recommendations are addressed below in the order used in the report.

The Water Club utilizes the MICROS Point of Sale System to control its ala carte restaurant and the flow of food and beverage from its kitchen and bars. It is also used to track and reconcile the daily cash and credit card receipts of the ala carte operation.

The banquet credit card payments are regularly entered in the Micros system as it is the only method to facilitate collection of funds from our credit card processor. Most of the banquet payments are received in the form of personal checks or wire transfers. A very, very small percentage of banquet payments are received as currency. Any and all payments are recorded in banquet department party folder and forwarded to the accounting office for inclusion in the accounting and general ledger records.

Ala Carte documents are currently maintained in electronic form permanently on accounting office computers. At your request, the Journal Reports will be added to the daily download and storage of reports. These journals will also be maintained permanently. Physical guest checks are maintained for six months to allow for credit card inquiries by customers.

A daily Cashier Report is prepared by each bartender. The report details cash taken in and payouts for gratuities and other items. The report is sent to the accounting office for reconciliation with the point of sale system. Very small differences are noted but more significant differences are investigated. The cashier reconciliation is an integral part of the daily accounting reconciliation of restaurant sales. To insure the integrity of the bar staff, we have and will continue to conduct spot integrity checks and tests. If we found a dishonest bartender, which is endemic to this business, we would terminate them.

The surveillance systems were installed to observe the proper procedures of the staff and insure the safety of company and customer personnel and property and to prevent false customer claims. The system is currently operating at maximum capacity. At the next upgrade, we will install a comprehensive system capable of more closely observing cash register transactions as you suggest.

The restaurant management and office staff have been made more aware of questionable transactions and cash drawer openings outside of the norm. The cash drawer function has been restricted and requires management intervention outside of regular transactions.

The restaurant service staff operates on a team basis. The purpose of the team concept is to afford maximum satisfaction to the customer. There is a captain, middle waiter, back waiter and bus person. Each person services the table and enters food and beverage items on the check as required. Customer checks are assigned to one individual by our point of sale system. Individual access codes would unnecessarily complicate service as they would not easily grant check access to other members of the team. The captain is the team leader who is responsible for all transactions relating to his assigned tables.

The same concept is used at the bar and also at the Crows Nest which accounts for about 4% of total sales. The deck floor manager is responsible at the Crow's Nest. Restricting the access to a customer's check to one individual would not be conducive to good customer service. Many times during service, a waiter leaves the floor to retrieve food from the main kitchen or higher end wine from the dining room storage area. Several members of the floor staff service the table. We currently assign Micros access codes on a team basis and will continue to hold the floor manager responsible for errors. Bartenders are identified by the daily cashiers report and only the bartender and floor manager have access to the cash drawer.

Gift certificates are currently consecutively numbered and maintained in a Gift Certificate Log book. We will use pre printed and pre numbered gift certificate stationary in the near future.

Several years ago we explored banquet reservation software and decided to retain our current system. The systems that we observed did not suit our needs nor did they afford any increase in control over our current system.

We will use pre-printed and pre-numbered stationery to assign consecutive numbers to our banquet contracts as suggested. We will continue our practice of recording these consecutively numbered banquet contracts in our contract log. A permanent record of banquet payments is currently maintained and recorded in our general ledger system. We will continue maintaining our "Banquet Transmittal" of all forms of payment as suggested. Receipts are currently prepared for all cash payments and issued to the customer. The receipts will be pre-printed and pre-numbered as suggested. Copies of the receipts and customer checks will continue to be maintained in the individual banquet files.

Financial transactions relating to customer banquets are currently entered into the general ledger in detail. Each party is assigned a unique account number which combines the date of the function and the contract number. All financial data relating to the party is recorded in this account. Each progress payment, the final bill and any final payment or refund is maintained as part of the company's permanent accounting records. This system facilitates management reporting and individual accounts receivable statements and balances. It affords a high level of accounting integrity

The tenant improvements were completed as required and details were made available to the auditors. We received no comments on our submission other than in this report. We will resubmit the documentation to EDC for their review as suggested.

As is endemic to this industry, every restaurant and catering facility occasionally has trouble with staff dipping into company receipts. Our goal is to afford the highest level of service and satisfaction to our customers while insuring that all due revenues are received and recorded. While we strive for perfection, our seeking of perfection is sometimes frustrated.

The audit was certainly thorough and while a few small problems will always arise, our overall effort is to produce the very best possible product in the way of food, service and our facility, to create a warm and welcoming ambience, to be a wonderful asset to the City and the community, to operate efficiently and give a proper accounting.

Sincerely,

Richard Dean

Richard Dean
Controller

CC: Amy Man – Comptrollers Office
John McFadden
Michael O'Keeffe

New York City
Economic Development
Corporation

Jason A. Wright
Executive Vice President
Chief Financial Officer

110 William Street
New York, NY 10038
Tel: 212.312.3727
Fax: 212 312 3913

jwright@nycedc.com
www.nycedc.com

December 21, 2010

Ms. Tina Kim
Deputy Comptroller for Audits
The City of New York
Office of the Comptroller
1 Centre Street
New York, New York 10007-2341

Re: Response to Audit Report on the Compliance of MDO Development Corporation with its Lease Agreement: FM10-126A

Dear Ms. Kim:

Thank you for the opportunity to respond to the above referenced Draft Audit Report, dated December 10, 2010.

Attached is a copy of NYCEDC's responses to your recommendations. If you or members of your staff have any questions please feel free to contact Becky Ta, NYCEDC's Head of Finance at (212) 312-3688.

Very truly yours,

Jason A. Wright

cc: Seth Pinsky
Dan Zarrilli
Larissa Belova
Steve Lazarus
Becky Ta
Hope Mallari

Recommendations to NYCEDC:

Recommendation 4: Ensure that MDO implements the proper controls necessary to address the deficiencies cited in this report.

NYCEDC's Response: *NYCEDC Agrees.*

NYCEDC will work with MDO to ensure that MDO utilizes proper controls to accurately record gross receipts.

Recommendation 5: Periodically monitor MDO to ensure that MDO maintains proper financial controls, that all receipts are recorded on MDO's books and records and on reports submitted to EDC. If MDO refuses to implement or maintain the proper controls, EDC should immediately inform the Department of Small Business Services so that it may consider terminating its lease agreement with MDO.

NYCEDC's Response: *NYCEDC partially agrees.*

NYCEDC agrees to monitor MDO periodically to ensure that proper controls are utilized and complete and accurate financial statements are submitted to NYCEDC. NYCEDC does and will continue to keep the Department of Small Business Services informed of MDO's compliance with the terms of the Lease.

Recommendation 6: Coordinate with MDO and develop a plan to complete the tenant improvements as required under Article 18 in the lease agreement.

NYCEDC's Response: *NYCEDC agrees.*

NYCEDC will meet with MDO to develop a plan to complete the tenant improvements as required under the Lease.

Recommendation 7: Ensure that MDO completes tenant improvements as planned and submits complete documentation supporting the costs associated with the improvements .

NYCEDC's Response: *NYCEDC agrees.*

NYCEDC will continue to enforce the Lease and ensure that MDO complies with the plan to complete the required tenant improvements and submits documentation to support the associated costs.

Recommendation 8: Perform a thorough review of the documentation and improvements to ensure that the tenant improvements and associated costs meet the requirements of the contract.

NYCEDC's Response: *NYCEDC agrees.*

NYCEDC will ensure that all completed tenant improvements meet the requirements under the Lease.