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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

December 14, 1999

Mr. Timothy S. Carey
President and Chief Executive Officer
Battery Park City Authority
One World Financial Center
New York, NY 10281-1097

Re: Internal Controls Over Revenues
Report 98-N-16

Dear Mr. Carey:

Pursuant to Article X, Section 5 of the State Constitution and Section 2503 of the Public Authorities Law, we audited the internal controls over revenues at Battery Park City Authority (Authority) for the period November 1, 1996 through February 28, 1999.

A. Background

New York State adopted the Battery Park City Authority Act in 1968, creating the Battery Park City Authority (Authority) as a public benefit corporation that would supervise the development of a 92-acre site. The site was created from landfill and is located on the lower west side of Manhattan, along the Hudson River. It is being developed as a mixed commercial and residential community, in accordance with a 1979 master plan. The Authority is governed by a three-member Board appointed by the Governor with advice and consent from the New York State Senate.

The Authority has leased portions of the site, in the form of numbered parcels, to private developers who retained contractors to develop them according to provisions of the master plan. Included in this plan are 14,100 housing units; 6 million square feet of office space; a commodities exchange; public space incorporating parks, plazas, and an esplanade; a hotel; a marina; public elementary, intermediate, and high schools; a museum; and related infrastructure.

For the fiscal year that ended on October 31, 1998, the Authority reported the following revenues:

Revenue from ground leases:		
Base rent	$24,669,251	
Supplemental rent	1,718,707	
Payments in lieu of real estate taxes	80,262,972	
Civic facilities and other payments	5,040,332	
		$111,691,262
Investment income on funds relating to:		
Housing Revenue Bonds	$694,288	
1993 Master Revenue Resolution	5,958,020	
1993 Revenue Refunding Bonds	2,718,770	
1996 Junior Revenue Bonds	2,215,034	
Temporary investments	1,957,275	
Net increase in the fair value of investments		13,543,387
Interest income on receivable from the housing company		8,001,300
		$133,235,949

B. Audit Scope, Objective and Methodology

We audited the internal controls over the Authority's revenues from November 1, 1996 through February 28, 1999. Our objective was to determine whether adequate controls were in place to ensure that rents had been calculated properly and that deficiency calculations were accurate. To determine how the amounts charged to the lessees were calculated, and to assess the adequacy of the Authority's internal controls over collection and handling of revenues, we reviewed various leases. We also reviewed the Authority's investment guidelines to determine whether they are in compliance with the State Comptroller's Standards for Internal Control in New York State Government.

To accomplish our objective, we reviewed and analyzed relevant Authority records and interviewed appropriate Authority managers and staff. We also visually verified all buildings and then traced them back to Authority records.

We conducted our audit according to generally accepted government auditing standards. Such standards require that we plan and do our audit to adequately assess those procedures and operations included within the audit scope. Further, these standards require that we understand the Authority's internal control systems and compliance with those laws, rules and regulations that are relevant to the Authority's procedures and operations that are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our efforts on those procedures and operations identified through our preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use our finite audit resources to identify where and how improvements can be made. Thus, we devote little audit effort to reviewing procedures and operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, generally highlights those areas needing improvement and does not address activities that may be functioning properly.

C. Internal Control and Compliance Summary

Our analysis of the internal control structure relating to revenues found that controls were good. However, we did identify two minor areas in need of improvement. These matters are presented in the following section of this report.

D. Results of Audit

Based upon our analysis of the internal control structure relating to revenues, we conclude that controls are generally good. We identified two minor matters, in the areas of percentage rent and investment practices, which Authority officials may wish to address to further strengthen internal controls.

1. Percentage Rent

Under provisions of the lease agreements, revenue from ground leases is recognized as income when it becomes receivable, although the Authority defers payments-in-lieu-of-taxes (PILOTs) that are received in advance, and recognizes them as income during the period to which they apply.

Percentage rent is a small portion of the rent that the tenant is obligated to pay to the landlord as consideration for the ground lease. The larger components of rent are base rent and PILOTs. Other components are supplemental rent, payments-in-lieu-of-sales-taxes, and civic facilities payments. All components are paid according to a formula and time specified in the lease agreement. For example, base rent is paid monthly, while PILOTs are paid quarterly and percentage rent payments are made quarterly or semiannually. Generally, the tenant calculates the percentage rent based on the amount of nonresidential rentable space used, or a percentage of Net Fixed Rent. Battery Place Associates and South Cove Associates base the amount of percentage rent they owe on the amount of nonresidential space they use. For the World Financial Properties A, B, C, and D, percentage rent is the difference between the Net Fixed Rent they owe for the base year and the Net Fixed Rent they owe for the current year times 5 percent. According to the lease agreement, Battery Place Associates and South Cove Associates should pay their percentage rent on a quarterly basis. To ensure that the Authority is getting the correct and accurate amounts of percentage rent, the lease requires the tenant to submit annual, semiannual and quarterly percentage rent statements. The lease also requires that an independent public accounting firm certify the annual percentage rent statement. According to Generally Accepted Accounting Principles, the Authority should accrue the percentage rent when it is earned.

We examined all 31 leases and their related revenue accounts, and found that the Authority did not accrue or record percentage rent for 3 eligible tenants, World Financial Properties D, Battery Place Associates (site 11), and South Cove Associates (site 10). Furthermore, we could not verify the accuracy or sufficiency of the percentage rent paid for two of the tenants, Battery Place Associates (site 11) and South Cove Associates (site 10). During the full two fiscal years we examined, 1996-97 and 1997-98, no percentage rent was recorded in the general ledger for two of the three tenants. No such rent was recorded during the first of these fiscal years for the third tenant.

As required by their leases, World Financial Properties A, B, C, and D, where appropriate, did submit their annual and base year percentage rent statements. From these statements, we were able to verify that World Financial Properties A and C do not owe percentage rent because their Net Fixed Rent is less than their base year's Net Fixed Rent. However, although World Financial Properties D is eligible to begin payment from July 1998, the Authority did not accrue the prorated portion of the percentage rent due for fiscal year 1997-98. We were unable to duplicate the verification of percentage rent for South Cove Associates and Battery Place Associates because, unlike World Financial Properties, neither submitted an independently-certified annual or quarterly statement as required by the lease. The Authority received, but did not accrue, the 1997-98 percentage rent from South Cove Associates and Battery Place Associates. In October 1998, the Authority received percentage rent from South Cove Associates for the period July 1, 1998 through September 30, 1998; and in January 1999 it received percentage rent for the next quarter, October 1, 1998 through December 31, 1998. However, the Authority did not accrue this receipt in its fiscal year 1997-98 accounting records. Nor did those records show that the Authority had also received percentage rent from Battery Place Associates in January 1999. Of the 31 leases, 6 tenants are required to pay percentage rent; but, under their leases, 2

of those did not owe that rent to the Authority for the years we reviewed. Moreover, one tenant is scheduled to begin payment outside our audit scope, in July 2000. The following tenants are required to pay percentage rent:

Buildings	**Percentage Rent Start**
WFP American Express Building C	July 1, 1996
World Financial Property A	July 1, 1996
World Financial Property B	July 1, 2000
World Financial Property D	July 1, 1998
South Cove Associates (site 10)	July 1, 1998*
Battery Place Associates (site 11)	January 1, 1998*

*Although the leases require percentage rent to be paid from the date the tenant first received nonresidential revenue, these dates are based upon tenant documentation only, and are therefore unaudited.

Percentage rent tenants account for a small portion of the Authority's revenue. Authority officials stated that they are pursuing collection of the percentage rents in question, but their position is that it would not be cost effective at this time to pursue litigation over what amounts to .015 percent of its revenue stream.

Since the Authority did not accrue any percentage rent due for the 1996-97 and 1997-98 fiscal years, its revenue for those two years was underreported. We could not determine the underreported amount because the Authority never received the required annual or quarterly percentage rent statements from its tenants. Therefore, for fiscal year 1997-98, the Authority underreported at least $18,113 in revenue - $2,840 from South Cove Associates and $15,273 from Battery Place Associates. The Authority loses interest income when it does not receive rental income on time, even if it charges late fees.

Authority officials indicated to us that they will pursue late fees on the amounts due that have not yet been determined.

2. Investment Practices

The Authority's Fiscal Policies and Procedures Manual (Manual) requires that investment practices, including the verification of securities held, be reviewed and tested by internal auditors on a surprise basis at least once a year.

According to its fiscal year 1998 financial statements, the Authority's investment portfolio totaled approximately $276.3 million, or roughly 36 percent of its total assets. The Authority has not conducted an internal review of investment practices. In addition, no separate reports were issued on investments from 1995 to 1998. Authority officials stated it was not necessary for an internal review because one is performed as part of the annual audit by independent auditors, and they were satisfied with that review. They also noted that a 1990 report by a certified public accounting firm recommended that the Authority not perform internal audits of its investments. However, the 1993 revision of the Manual, three years after the abovementioned 1990 report, still required an internal review on a surprise basis at least once a year. It is the Authority's position that it has implemented a more-than-adequate review of its investment practices and that, despite the guidelines stated in the Manual, those practices do not warrant an annual review by the Internal Audit department. We believe that the procedures followed by the Authority should be consistent with its Manual.

Recommendations

1. *Record all revenues as they are earned.*

2. *Ensure that tenants submit their annual and quarterly percentage rent statements on time, as required by the lease agreement.*

3. *Amend the Fiscal Policies and Procedures Manual to reflect current practice with respect to annual reviews of investment practices by the internal audit staff.*

We provided a draft copy of the matters contained in this report to Authority officials for their review and comment. Their comments have been considered in preparing this report and are included as Appendix A. Authority officials agree with our recommendations and stated they are taking steps to implement them.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the President and Chief Executive Officer of Battery Park City Authority shall report to the Governor, the State Comptroller, and the leaders of the Legislature and its fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Major contributors to this report were Howard Feigenbaum, Stuart Dolgon, Myron Goldmeer, Irina Herman, Alina Mattie and Orin Ninvalle.

We wish to thank the management and staff of the Battery Park City Authority for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Kevin M. McClune
Audit Director

cc: Charles Conaway
Enzo Iannozzi

Timothy S. Carey
President / CEO

BATTERY PARK CITY AUTHORITY

November 17, 1999

Mr. Kevin M. McClune
Audit Director
State of New York
Office of the State Comptroller
A.E. Smith State Office Building
Albany New York 12236-0001

Dear Mr. McClune,

Thank you for the opportunity to respond to the Office of State Comptroller's draft audit report No. (98-N-16) of the Hugh L. Carey Battery Park City Authority(Authority) internal control over revenue. As your report noted, there are minor matters in the areas of percentage rent and investment practices the Authority should review.

Regarding the recommendation concerning annual reviews of investment practices, the Authority is in the process of reviewing all procedures and practices. The investment manual will reflect that the Authority's Internal Audit department will have the right to review investments, whenever Senior management and/or the Vice President, Internal Audit believe it is warranted. This policy was always implied in the current manual and will be clearly reflected in the revised manual.

For the two remaining recommendations regarding recording revenues and submissions of rent statements, rest assured that it is the Authority's policy to record all revenue as earned and all terms of the lease agreement are adhered to by our tenants.

Very truly yours,

Timothy S. Carey
President/CEO

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