NEW YORK STATE
OFFICE OF THE STATE COMPTROLLER

H. Carl McCall
STATE COMPTROLLER

NEW YORK STATE OFFICE OF PARKS, RECREATION AND HISTORIC PRESERVATION

Administration of Contract X00310
Bethpage Associates, LLC

2001-R-4

DIVISION OF MANAGEMENT AUDIT AND
STATE FINANCIAL SERVICES

OSC Management Audit reports can be accessed via the OSC Web Page:

http://www.osc.state.ny.us

If you wish your name to be deleted from our mailing list or if your address has changed,

contact the Management Audit Group at (518) 474-3271

or at the

Office of the State Comptroller

110 State Street

11th Floor

Albany, NY 12236

H. Carl McCall
STATE COMPTROLLER

Report 2001-R-4

Ms. Bernadette Castro
Commissioner
New York State Office of Parks, Recreation and Historic Preservation
Empire State Plaza, Agency Building 1
Albany, NY 12238

Dear Ms. Castro:

The following is a report of our audit of Contract X00310 between the New York State Office of Parks, Recreation and Historic Preservation and Bethpage Associates, LLC.

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1, of the State Constitution; and Article II, Section 8, of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of Management Audit
and State Financial Services

December 26, 2002

EXECUTIVE SUMMARY

New York State Office of Parks, Recreation and Historic Preservation

Administration of Contract X00310

Bethpage Associates, LLC

SCOPE OF AUDIT

In 1998, the New York State Office of Parks, Recreation and Historic Preservation (Parks) awarded a 20-year license agreement (Contract X00310) to Bethpage Associates, LLC (Bethpage), to provide food and beverage services at the Bethpage State Park's clubhouse, golf course refreshment stands, picnic area, polo field, and catering facility. Bethpage agreed to pay Parks a license fee based on a percentage of the gross receipts generated, and was also required to invest $2.5 million in capital improvements in the clubhouse area, parking lot, and golf course refreshment stands during the first three years of the Contract, as well as renovations and modifications to the existing country club building. In addition, Bethpage was to establish an interest-bearing checking account entitled "Bethpage F&B Replacement & Refurbishment Account (R&R Account)" and to deposit 3 percent of its gross receipts in the account each month.

This financial-related audit, which covered the period of April 1, 1998 through December 31, 2001, addressed the following questions:

- Is Bethpage Associates, LLC complying with the Contract's terms?
- Is Parks' oversight of Bethpage Associates' operations adequate?

AUDIT OBSERVATIONS AND CONCLUSIONS

Our audit found that the respective internal control structures Parks and Bethpage have established over Contract operations do not provide adequate assurance that revenues are being recorded, deposited, or reported accurately -- nor that Bethpage is making required deposits to the R&R Account. We also found that Bethpage had not paid the required monthly license fees -- a total of $300,000 -- for the six-month period of March through August 2001. In addition, despite the fact that the catering operation provides most of Bethpage's revenue, Parks was not monitoring it. While Bethpage prepared two monthly

reports regarding its catering activity, Parks officials did not review them; nor did they assess the accuracy of the revenues listed. (See pp 5-8)

Although Bethpage's gross annual sales have exceeded $100,000, the company has not submitted either audited or unaudited financial statements to Parks officials, as required. When we obtained the unaudited statements prepared for 1999 and 2000, we found that Bethpage had not reported $151,800 of its income to Parks. As required, Bethpage has been providing Parks with detailed revenue reports of its noncatering-related food and beverage revenues, but we found that Parks officials had not even opened the reports until we brought them to their attention. Our review of a sample of these revenue-related reports found they contained incomplete and inconsistent information; thus there is no assurance that Bethpage properly recorded, deposited, and included all food and beverage revenues as a basis for calculating license fees. (See pp 8-11)

Bethpage was required to invest a minimum of $2.5 million in capital improvements at the Bethpage State Park facility during the first three years of the Contract. We reviewed all related payment documentation and toured facilities to verify that the required capital improvements had been made. We found that Bethpage exceeded its contractual obligation of $2.5 million of capital improvements. As of December 2000, Bethpage reported that costs had escalated to about $9 million. However, Parks did not provide Bethpage with adequate oversight during the capital improvement phase, which may have contributed to the excessive costs incurred. Parks did not formally approve the additional capital costs, the bidders' list or the subcontracts awarded by Bethpage. Nor did Bethpage submit any invoices to Parks before paying vendors. (See pp 13-15)

We also found that Bethpage has not made all required deposits to the R&R Account. In fact, Parks officials did not even know the account existed and thus had no control over the use of its funds. For the period of March 1998 through December 31, 2001, based on reported revenue, we calculate that Bethpage should have deposited $476,815 in the account. However, during this period, deposits of just $263,618 were made – a shortage of $213,197. We note that no further deposits have been made to the R&R Account since September 2000; and the account balance as of November 30, 2001, totaled just $787. We were informed that Bethpage had withdrawn the balance in the account to pay for capital improvements. Because Parks and Bethpage officials were able to demonstrate to the Office of the State Comptroller's Bureau of Contracts that Bethpage had made purchases and refurbishments for capital improvements that would qualify as R&R Account expenditures, the contractor was granted $1.2 million in relief for past and future R&R Account obligations. (See pp 17-18)

COMMENTS OF OFFICE OFFICIALS

Parks officials believe that our report does not highlight the successes of the public-private partnership Parks has forged with Bethpage resulting in a world-class golfing facility and greatly enhanced Park revenues. Parks, in its response, cites such successes. However, in general, Parks officials agreed with our audit recommendations and indicated that they have already implemented several of them, and are taking steps to implement the remaining ones.

CONTENTS

INTRODUCTION

Background

In 1998, the New York State Office of Parks, Recreation and Historic Preservation (Parks) awarded a 20-year license agreement (Contract X00310) to Bethpage Associates, LLC (Bethpage), to provide food and beverage services at the Bethpage State Park's clubhouse, golf course refreshment stands, picnic area, polo field, and catering facility.

As consideration for this exclusive license, Bethpage agreed to pay Parks a license fee based on a percentage of the gross receipts generated. The gross receipts exclude any excise and sales tax, gratuities, refunds, or discounts.

The highlights of the Bethpage Contract are as follows:

- Bethpage must pay a license fee to the State of 9.5 percent of the gross revenues realized each month in each of the concession categories. The fee is due by the 15th of the month after the revenues are collected. Bethpage may be held liable for a penalty of 2 percent per month for any part of the license fee that is not paid as required.

- Bethpage is required to invest $2.5 million in capital improvements during the first three years of the Contract. The capital improvements were to be made in the clubhouse area, parking lot, and golf course refreshment stands. Bethpage is also responsible for renovations and modifications to the existing clubhouse building.

- Bethpage is also required to establish a distinct and separate interest-bearing checking account for capital refurbishment entitled "Bethpage F&B Replacement & Refurbishment Account (R&R Account)." Three percent of gross receipts are to be deposited in this account each month for the purchase, replacement, or refurbishment of necessary equipment and property. Untimely deposits are subject to a 2-percent penalty fee.

Parks oversees Bethpage's performance through three of its offices: the Division of Administration and Finance located in Albany (Parks Headquarters), the Long Island Regional Office (Regional Office) at Belmont State Park; and its on-site office at Bethpage State Park (Bethpage Office), where the golf course is located.

Audit Scope, Objectives and Methodology

In this financial-related audit, we reviewed the Contract-related operations of Bethpage Associates at Bethpage State Park for the period April 1, 1998 through December 31, 2001. Our audit objectives were to assess contractor compliance with Contract terms, and Parks oversight of contractor operations. Specifically, we reviewed the contractor's adherence to internal controls over revenue operations, including the receipt, recording, depositing, and revenue-transmittal functions; as well as its compliance with capital-investment and R&R Account requirements.

To accomplish our objectives, we tested the internal controls in place over the Bethpage Associates revenue operations; observed accounting procedures in place at each point of sale; and examined and tested the accuracy of selected documents, sales records, related financial information provided by both Parks and Bethpage Associates, and the Contract files. We also reviewed various planning documents related to the required capital projects, and the bank statements of the R&R Account. We met with Parks and Bethpage officials and obtained and reviewed the available documents used to control and monitor Contract operations.

Internal Control and Compliance Summary

Our consideration of Parks and Bethpage Associates respective internal control structures over Contract operations found that they did not provide adequate assurance that revenues were being recorded, deposited, or reported accurately -- nor that required deposits in the R&R Account were made by Bethpage Associates. We will provide details of these matters throughout this report.

Response of Parks Officials

A draft copy of this report was provided to Parks and Bethpage officials for their review and comment. Their comments have been considered in preparing this report, and are included in their entirety as Appendix B.

Parks officials believe that our report does not highlight the successes of the public-private partnership Parks has forged with Bethpage resulting in a world-class golfing facility and greatly enhanced Park revenues. Parks, in its response, cites such successes. However, in general, Parks officials agreed with our audit recommendations and indicated that they have already implemented several of them and are taking steps to implement the remaining ones. Excerpts from Parks response have been included in the text of this report.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Office of Parks, Recreation and Historic Preservation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

REVENUES

Bethpage's primary revenue-generating operations include its golf-related concessions, a clubhouse restaurant, and an on-site catering business. The following table illustrates revenues reported by these operations and the corresponding license fee for calendar years 1998 to 2001:

ANNUAL REVENUES

Revenue-Generating Operations	1998	1999	2000	2001	Total
Golf-Related Concessions	$ 734,869	$ 724,026	$ 602,949	$ 651,884	$ 2,713,728
Restaurant	354,006	2,576	729,626	1,230,343	2,316,551
Catering	472,468	3,075,260	4,662,493	5,090,791	13,301,012
Total	1,561,343	3,801,862	5,995,068	6,973,018	18,331,291
Less: Gratuity	56,470	469,179	711,230	780,849	2,017,728
Less: Sales Tax	110,171	57,387	104,395	147,837	419,790
Total Revenues	$1,394,702	$3,275,296	$5,179,443	$6,044,332	$15,893,773
9.5% License Fee	$132,497	$311,153	$492,047	$574,212*	$1,509,909

* Actual total payments of $274,212 were made to the State, as explained in the report section entitled "License Fees to the State."

Bethpage prepares monthly summary revenue reports that are used to calculate the monthly license fee. To assess the integrity of these reports and the accuracy of the corresponding license fees, we reviewed the internal controls in place over the various revenue collection points at Bethpage State Park, compared the reported revenues with bank deposits, performed several revenue-reasonableness tests, and traced selected receipts from the point of collection to Bethpage's summary revenue reports. We found that Bethpage had not paid all required license fees, and we identified several opportunities for improving internal controls over Bethpage revenues.

License Fees to the State

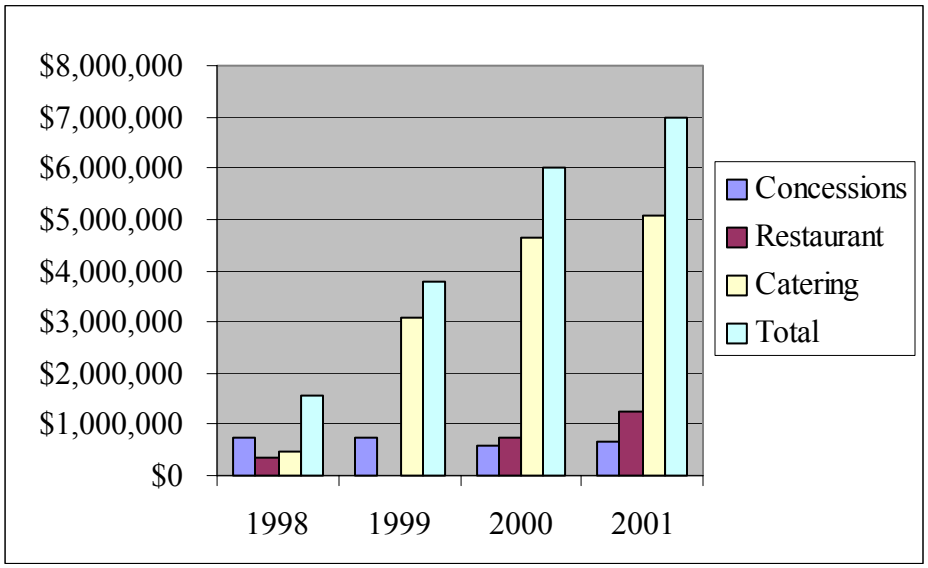
We found that Bethpage officials had not remitted to the State the required monthly license fees -- a total of $300,000 -- for the six-month period of March through August 2001. According to Parks officials, the license fees in question were withheld with Parks' prior knowledge, pending the anticipated approval of a Contract amendment submitted to the Office of the State Comptroller's (OSC) Bureau of Contracts that would have given Bethpage some financial relief in return for the excess capital improvements reportedly made by the contractor to the Bethpage State Park facilities.

Although Bethpage was required to make a minimum of just $2.5 million in capital improvements, it claims to have spent about $9 million on such improvements. With Parks approval, Bethpage officials withheld $300,000 in license fees during the audit period pursuant to the proposed Contract amendment. We note that, on June 27, 2002, OSC's Bureau of Contracts notified Parks that this amendment had not been approved. Thus, the process followed by Parks to allow Bethpage this credit without an approved contract amendment, was improper and contrary to the terms of the contract. However, subsequent to our field work, OSC's Bureau of Contracts received additional information documenting the basis for Parks decision to allow Bethpage to withhold the $300,000 in license fees. When it was determined that additional work was needed on the State's share of the HVAC system, a competitive process was conducted and Parks requested Bethpage's HVAC contractor perform this work at a cost of $300,000. Parks and Bethpage agreed that Bethpage would pay the contractor for this work on behalf of Parks and receive reimbursement in the form of a revenue credit. Since in the final analysis the $300,000 credit would be offset by the State's indebtedness for the HVAC work, the Bureau of Contracts has agreed to allow for this $300,000 credit through a contract amendment.

Catering Operation

As shown on the following chart, Bethpage's catering operation generates the overwhelming majority of it's Contract-related revenues. For example, for calendar year 2001, Bethpage reported catering revenues of $5,090,791, or 73 percent of its total revenues of $6,973,018.

Bethpage Revenue Sources



Despite the fact that it provides Bethpage's largest source of revenue, the catering operation is subject to virtually no monitoring by Parks.

Bethpage prepares two monthly reports regarding its catering activities:

- a calendar log provided at the beginning of each month lists all catering events for that month. It details the date, time, room, and name of each event.

- a revenue summary provided at the end of each month, that details the catering revenue generated during the prior month.

We found that Parks officials do not review these reports; nor do they assess the accuracy of the catering revenues listed. For example, using the information presented in these reports, Parks could compare the number of events listed on the calendar log with the events noted on the monthly revenue summary. Officials could also select a sample of events and calculate the corresponding revenues based on the number of participants and the amounts charged per person. No such tests have been performed by Parks officials. Nor is there evidence that they have requested, reviewed, or received any catering contracts.

To assess the integrity of Bethpage's reported catering revenues, we performed several such tests. We judgmentally selected the months of January, March, May, June, and September 2001 resulting in a total sample of 20 catering contracts to review. We recalculated the total cost, sales tax, and cost per person for each catered event, and compared it to the contract; and noted no differences. We also traced the corresponding totals to bank deposit slips and bank statements. All of the direct catering revenue received from these events had been recorded properly on the monthly reports that Bethpage Associates provided to Parks. However, as explained below, we noted that Bethpage had not been providing Parks with certain catering-related revenues such as referred fees from florists and interest earned on event deposits; nor had it calculated the corresponding license fees thereon.

The Contract stipulates "On or before the first day of April of each calendar year of this agreement, the Licensee shall provide Parks with a copy of a Statement of Income and Balance Sheet … and, if the gross sales exceeds $100,000 annually, it shall be reviewed by a Certified Public Accountant." Although Bethpage's gross annual sales have consistently exceeded $100,000, we found that it has not submitted any audited financial statements to Parks. For that matter, Parks officials have not even received copies of Bethpage's unaudited statements.

We obtained the unaudited financial statements prepared for Bethpage for 1999 and 2000, and reconciled the revenue reported thereon to the corresponding revenue reports the company used as a basis for the license fees. We found that Bethpage had not reported $151,800 of its income to Parks.

According to Bethpage officials, the unreported revenues related to interest income, promotion income (referral fees), and deposits received for cancelled events. Although the Contract states that any and all revenues received by Bethpage as a result of its exclusive license to operate at Bethpage State Park are includable as a basis for the license, Bethpage management told us that they believed these income categories were not reportable to Parks. Based on these underreported revenues for 1999 and 2000, Bethpage owes Parks $14,421.

(In response to our draft report, Parks officials stated that, historically, they had not considered ancillary income, such as

referral fees and interest income, as part of gross receipts subject to license fees. However, considering the statewide implications of this issue, they have referred this matter to their Counsel for review.

Parks officials also noted that Bethpage's in-house controller is a Certified Public Accountant and has been preparing financial statement in accordance with generally accepted accounting principles. Parks plans to reconcile these statements to reported revenue on a routing, interim basis. We note, however, that considering Bethpage's annual income, to comply with contract terms, it needs to submit financial statements audited by an independent certified public accountant.)

We also attempted to determine whether additional catering events had taken place that were not reported to Parks. Examining the records of the parking valet company Bethpage used for such events, we compared Bethpage's calendar of catering events for the period January 2001 to December 2001 with the company's records for the same time period. We found 20 occasions on which valet service had been provided to Bethpage where no catered events were recorded in the Bethpage calendar log.

According to Bethpage officials, on most of these dates, the valet service had been secured to handle increased activity anticipated for special events hosted by the restaurant, and not catered affairs. However, when we compared the reported revenue for these dates with the restaurant's average daily sales volume, we noted that the average revenue for these 20 dates ($4,598) – was on par with the Restaurant's average daily revenue. In fact, on three of these dates, the reported sales volume ($884, $997, and $1,086) was substantially below the average. Consequently, we could not firmly establish that the valet services had been secured for those dates to accommodate an anticipated higher level of activity in the restaurant – a further illustration of Parks' need to increase its monitoring of Bethpage's revenue operations.

(In response to our draft report, Parks officials offered additional possible reasons for the noted discrepancies. They cited restricted general parking at the clubhouse area due to preparations for the U.S. Open necessitating valet services for the convenience of Park customers – which would not have

necessarily resulted in increased revenue. Nevertheless, they will be diligent in tracking this concern in the future.)

Other Food and Beverage Revenues

In addition to the catering operations, Bethpage operates a restaurant and four satellite food and beverage facilities located throughout the facility grounds. The Contract stipulates certain control activities (e.g., daily cash register meter readings and periodic revenue reconciliations) that Bethpage and Parks are to apply to protect the integrity of revenue collections. In addition, Bethpage is to provide Parks with detailed revenue reports of food and beverage revenues by type and location. To reconcile monthly revenues, opening and closing cash balances must also be provided.

Bethpage Associates provides a weekly report, which is summarized monthly, to Parks' Bethpage Office; as well as a monthly report to Parks' Regional Office. We found that Parks officials do not reconcile these reports. In fact, Parks officials at the Bethpage Office had not even opened the packets containing the detailed weekly reports at the time of our inquiry.

When we reviewed the monthly reports made to the Regional Office, we noted that some did not contain the required opening and closing balances. For example, for restaurant revenues, no opening or closing balances were reported from May 2000 to December 2001. For revenues from the four satellite locations -- each of which has its own cash register -- balances were not shown from May 2001 to August 2001. By September 2001, when Bethpage began reporting opening balances, each of the four registers showed a difference between the reported balance and actual cash on hand. Three registers overstated their September opening balances because of "over-rings" of $782, $1,109, and $12,799. The balance on the remaining register showed a difference of -$13,218 (less than the reported opening balance) reportedly the result of an electrical problem that caused the register to be reset. The net differences totaled $1,472.

Bethpage officials acknowledged that their reported revenue was understated in July 2001 by approximately $500. We also note that several restaurant revenue reports prepared in 1998 appear to be incorrect, considering the opening and closing balances listed in the reports. For example, the March report for

that year shows a closing balance of $15,080; but the report for the following month of April shows an opening balance of $5,910 -- a $9,170 difference. Furthermore, the July 1998 report shows an opening balance of $125,424 and a closing balance of $5,675, with reported net revenues for the month of $58,883 – indicating the ending balance should have increased.

Thus, considering the missing information and inconsistencies we noted between these reports, there is no assurance that Bethpage properly recorded, deposited, and reported all food and beverage revenues to be used as a basis for calculating the license fees it is obligated to pay.

Recommendations

1. Require Bethpage to remit all license fees in accordance with the Contract. Any exceptions should be approved, in advance, via a formal Contract amendment.

2. Reconcile all revenue-related reports provided to Parks. Specifically, reconcile the weekly report to the monthly report, trace reported revenue figures back to original source documents to verify that all pertinent data (e.g., opening and closing balances) have been provided, and follow up on any discrepancies. Obtain the appropriate license fee resulting from the underreported income in July 2001.

3. Reconcile the two monthly catering reports that are being provided, and record all daily events occurring at the clubhouse. Compare this event data with relevant data in the monthly reports.

4. Verify that Bethpage is including all contract-related income in gross receipts when it calculates the license fee. Collect and remit the $14,421 in additional license fees it owes the State for 1999 and 2000. Recalculate the additional license fees that are due, and remit them to the State for prior and subsequent periods.

5. Follow up on the dates valet services were reportedly provided to Bethpage, where corresponding events were not listed on the catering log. Determine whether any income was not reported for those dates – and if so – recoup the appropriate license fee.

Recommendations (Cont'd)

6. Ensure Bethpage submits the required audited financial statements, and reconcile the statements to reported revenues.

CAPITAL IMPROVEMENTS

As part of its contractual obligation, Bethpage was required to invest a minimum of $2.5 million in capital improvements at the Bethpage State Park facility during the first three years of the Contract. The specific capital improvements outlined in the Contract include the clubhouse area, parking lot, and golf course refreshment stands. Parks is responsible for monitoring Bethpage's compliance with these requirements.

To assess Bethpage's compliance therewith, we reviewed all related capital project payment documentation to determine the dollar value of the improvements paid for. We also took a physical tour of the Bethpage facilities to verify that the improvements had, in fact, been made. The improvements we observed included renovations in the clubhouse, cafeteria, and outdoor dining areas; as well as the parking lot and a locker room.

According to our meetings with Parks and Bethpage officials, Bethpage exceeded its contractual obligation of $2.5 million in capital improvements. Bethpage officials told us they had expected the noted improvements would require more than the $2.5 million obligation because the project(s) were significantly larger than the original bid would have covered. They said the cost of the improvements had escalated to about $9 million as of December 31, 2000, for various reasons, including unanticipated construction obstacles, historic preservation requirements, and the presence of asbestos. During the period of our fieldwork, a Court settlement of disputes between Bethpage and its subcontractors reduced total project costs to about $6.5 million.

For our review of supporting documentation for the work reportedly performed, we selected a judgmental sample of 14 capital improvement contracts between Bethpage and its subcontractors. These combined contracts exceeded $6 million.

Bethpage officials also provided us with payment documentation (e.g., cancelled checks) for the 14 contracts we selected, totaling $4.8 million. Thus, we were able to confirm that

Bethpage had paid out more than $2.5 million, thus meeting the minimum level of capital improvement investment required by the Contract.

Parks Oversight

We found that Parks did not provide Bethpage with adequate oversight during the capital improvement phase reported on above. We believe this lack of oversight may have contributed to the excessive costs incurred by Bethpage, and practices which did not comply with some of the pertinent Contract terms, such as the following:

- "Designs for all capital investment projects shall be subject to the prior written approval of Parks before any advertising for or acceptance of bids, or the award of contracts for construction."

We found that Parks did not formally approve any bid invitations issued, or contracts awarded, by Bethpage.

- "All capital expenditures must be approved by Parks."

Parks officials told us that, while some capital expenditure projects were formally approved in advance, the majority of them were not.

.

- "Verification of the costs of all work undertaken (by Bethpage) shall be submitted to Parks prior to payment."

Bethpage did not submit any invoices to Parks before obligating itself to subcontractor vendors.

- "Any capital expenses in excess of originally estimated costs of the projects proposed by the Licensee and approved by Parks shall be the sole responsibility of the Licensee and Parks shall have no liability whatsoever for such additional expenses either to the licensee or the Licensee's contractors, subcontractors, and/or suppliers."

We found no evidence that Parks gave prior approval for any of the additional (i.e., greater than $2.5 million) capital costs Bethpage incurred.

In summary, Parks did not adequately monitor the capital improvements made by Bethpage and permitted construction to proceed before giving its approval. If Parks officials had employed proper contract monitoring techniques, they might have been able to minimize the cost overruns noted in this report and the contractors' associated requests for relief.

When we discussed this issue with Parks officials, they agreed that they did not have the presence they should have had at Bethpage State Park during the initial construction phase. They stated that they are currently working with Bethpage to verify that all contract requirements regarding capital improvements are being met.

(In response to our draft report, Parks officials reiterated the capital project achievements realized as a result of its partnership with Bethpage, and asserted that they have formalized their monitoring procedures for all future capital projects.)

Recommendations

7. Document Parks review of all capital improvements made by Bethpage to date at Bethpage State Park.

8. Monitor all future Parks projects to ensure that all Contract terms are complied with.

REPLACEMENT AND REFURBISHMENT ACCOUNT

According to the Contract, monies in the R&R Account are to remain distinct and separate from the licensee fee Bethpage pays Parks. Withdrawals are to be allowed only upon the signatures of designated representatives of both Bethpage and Parks, who have been authorized to sign checks against the R&R Account. The checkbook is to be kept in the Parks Regional Office, where the bank is to send its monthly account statements directly. Parks is also to provide Bethpage with a copy of a monthly reconciliation report. In addition, Bethpage is to make deposits in the R&R Account on the 15th day of each month of the license term, and provide Parks with copies of all deposit slips. Then Parks would be able to reconcile the statements to the checkbook and corresponding deposits.

We found that all required deposits to the R&R Account had not been made. In addition, no authorized Parks signatory had been established for the R&R Account; the checkbook was not kept at the Regional Office; and the bank statements were not being sent to the Regional Office. In fact, Parks officials told us during our fieldwork that Parks did not know whether such an account existed. As a result, Parks had no control over this account.

For the period March 1, 1998 through December 31, 2001, we calculated that Bethpage should have deposited $476,815 in the R&R Account based on reported revenues. However, Bethpage deposited just $263,618 during this period, $213,197 less than its obligation. We noted that no further deposits had been made to the R&R Account since September 2000; and the account balance as of November 30, 2001, totaled just $787. We were informed that Bethpage had withdrawn the balance in the account to pay for capital improvements.

Bethpage officials told us that they had informed Parks when they created the R&R Account by requesting a signatory to authorize withdrawals. However, they stated that Parks officials had never responded to their request. Further, Bethpage officials explained that they had not made the required deposits

because of the increased costs of the capital improvement projects which left them without sufficient funds for deposits. They also said they believed that many of the capital improvements they had made included purchases and refurbishments that would qualify as R&R Account expenditures. Therefore, because they had believed they had met their account-management obligations, they requested $1.2 million in relief for past and future R&R Account obligations. Subsequent to our fieldwork, the Office of the State Comptroller's Bureau of Contracts granted Bethpage such relief.

(In response to our draft report, Parks officials assert that they have taken steps to ensure compliance with R&R Account activities.)

Recommendations

9. Enforce Bethpage compliance with the Contract requirement to establish the R&R Account. Maintain the Account checkbook and verify that bank statements are being sent directly to Parks' Regional Office.

10. Ensure that Bethpage Associates is depositing the required amount of funds into the R&R Account in a timely manner, bringing the account balance to its appropriate level, considering the relief granted on June 27, 2002.

11. Follow up on late or missed deposits immediately. Evaluate the need to impose a penalty assessment against Bethpage Associates whenever timely deposits are not made in the R&R Account.

12. Obtain the budget and schedule of proposed expenditures that will be made when funds are withdrawn from the R&R Account. Require that all such expenditures be documented.

MAJOR CONTRIBUTORS TO THIS REPORT

William Challice

Frank Patone

Wayne Sickler

Aaron Fruchter

Cathy Smith

David Louie

Carole LeMieux

Anthony Carlo

Alison Pingelski

Altagracia Rodriquez

Marticia Madory

New York State Office of Parks, Recreation and Historic Preservation
The Governor Nelson A. Rockefeller Empire State Plaza
Agency Building 1, Albany, New York 12238

Bernadette Castro
Commissioner

518-474-0456
Human Resources
518-474-0453
Fiscal Management
518-474-0061
TDD: 518-486-1899

November 25, 2002

Mr. William P. Challice
Audit Director
Office of the State Comptroller
Division of Management Audit & State Financial Services
123 William Street, 21st Floor
New York, New York 10038

Re: Draft Audit Report (2001-R-4)
Contract X-000310
Bethpage Associates, LLC

Dear Mr. Challice:

The Draft Audit Report (2001-R-4) (hereinafter the "Report") on the Contract X-000310 between the New York State Office of Parks, Recreation, and Historic Preservation ("State Parks" or the "Agency") and Bethpage Associates, LLC. ("BA") has been received and reviewed by our Agency. We offer the following response as requested in your September 25, 2002 correspondence.

State Parks' concession program is based on the reallocation of capital and operational costs associated with recreational facilities and services from the State to the private sector. The goal is to capture the creativity, entrepreneurial spirit and financial resources of private business in providing first class services at affordable prices in furtherance of State Parks' mission to provide safe and enjoyable recreation to all. Our mission takes precedence over profit as reflected in State Parks' contractual control over pricing and quality of products and services, and steadfast commitment to realizing capital improvements and amenities akin to those available at private facilities. By these measures, the State Parks' partnership with BA has been an unqualified success. Since completion of renovations, BA's operation at Bethpage has been voted the best catering establishment on Long Island, and was an integral part of the success of the 2002 United States Open Championship (the "U.S. Open"). In 2001 alone, the Agency's revenue return exceeded the best annual return by a prior concessionaire by nearly $20,000, *even factoring in deduction of an approved $300,000 credit for BA as provided for in the amended Contract.*

Background is critical. Prior to 1997, the concessions at Bethpage State Park were in dire need of capital improvement. The aging physical plant of the clubhouse fell victim to time, deferred maintenance and modest State resources available for refurbishment. Prior concession agreements were relatively short term and could not support substantial capital investment by the private sector. Because concession revenue was grossly

Appendix B

insufficient to fund significant change, capital improvement projects were undertaken on an *ad hoc* basis and were relatively modest in scope. The long-term license awarded to BA, in conjunction with a separate, long-term license for the golf concessions and the State's unprecedented agreement for the U.S. Open has changed that. The common denominator of these agreements was mustering substantial private sector investment in the improvement and enhancement of park infrastructure necessary to establish Bethpage State Park as a top quality facility. The success of the program is borne out by what is now undoubtedly a premier catering and food service venue to complement the world's finest public golf complex.

While the success of the Agency's public-private partnership with BA is obvious, because the Report adopts a risk-based perspective, the great accomplishments at Bethpage are downplayed, or not addressed at all. BA's renovation of the clubhouse resulted in the expenditure of approximately $9.0 million in capital improvements that far exceeded the $2.5 million investment required by BA's original commitment. This enhanced private-sector investment not only substantially increased the intrinsic value of the State-owned property at Bethpage, but also created a greatly enhanced revenue stream that will be shared in by the State over the remainder of the 20-year term.

BA's capital project did generate construction-related claims, some litigation, and a corporate restructuring of BA in 2001 that threatened the success of the project. However, all of these issues have been resolved. Moreover, throughout the course of the audit, State Parks and BA pursued the amendment of the Contract to resolve issues, achieve equity with respect to the enhanced capital investment by BA, and to facilitate future management and administration of the Contract. Throughout the process, an ongoing dialogue and series of written justifications for the amendment, including disclosure of the circumstances surrounding the completion of BA's capital project was presented in great detail to OSC. On October 22, 2002, the revised Contract amendment was formally approved by control agencies. The auditors were privy to these documents and dialogue throughout the course of the audit. However, the Report focuses largely on the terms of the original agreement and not the Contract amendment, much of which was crafted to address the very issues identified in the audit findings.

Since the corporate restructuring of BA and resolution of construction-related claims, BA and State Parks have committed to developing a stronger working relationship to ensure that information affecting the State's return is accurate and complete. With the resolution reflected by the terms of the amended Contract, BA was restructured and brought under the managerial control of its original owner. Since that transition, day-to-day operations have been transformed, and a solid working relationship has been forged. The amended Contract is comprehensive and clarifies many specific issues surrounding day-to-day operations to ensure a clear audit trail for revenues and an objective basis on which to evaluate BA's performance. Notwithstanding some of the assertions contained in the Report, we believe that the OSC audit process has disclosed that BA has a fundamentally sound business office, and is running an effective and efficient business.

The following is in response to the specific recommendations in the Report:

Report Findings: Revenues

Recommendation #1:

Require Bethpage to remit all license fees in accordance with the Contract. Any exceptions should be approved in advance via a formal Contract amendment.

Response #1:

State Parks has required and will continue to require BA to remit all License fees in accordance with the Contract. State Parks agrees that any material exceptions should be approved in advance via a formal Contract amendment.

The Report discusses a $300,000 credit granted to BA against license fees due to State Parks in 2001. This credit was in accordance with the amended terms of the Contract and was created because BA assumed $300,000 in construction costs in State-retained areas during the renovation of the Bethpage clubhouse. This credit was specifically included in the proposed Contract amendment that was pending approval throughout the course of the audit. The amendment has now been duly approved by OSC, and therefore this credit was determined to be appropriate by OSC. State Parks is not aware of any other license fees that have not been remitted by BA on time.

Recommendation #2:

Reconcile all revenue-related reports provided to Parks. Specifically, reconcile the weekly report to the monthly report, trace reported revenue figures back to original source documents to verify that all pertinent data (e.g., opening and closing balances) have been provided, and follow up on any discrepancies. Obtain the appropriate license fee resulting from the underreported income in July 2001.

Response #2:

The Agency routinely engages in reconciliation of periodic revenue reports for purposes of ensuring accuracy of reported revenues, and will continue to enhance and refine the practice. State Parks agrees that the improvement of audit and control procedures to ensure a solid system of reconciliation is a continuing goal in contract administration. State Parks will investigate any discrepancies pertaining to July 2001 revenue reports and take appropriate action. It is noted that discrepancies in BA's accounting of revenues have been rare and license fee payments have been prompt.

Recommendation #3:

Reconcile the two monthly catering reports that are being provided, and record all daily events occurring at the clubhouse. Compare this event data with relevant data in the monthly reports.

Response #3:

Please see Response #2. New language in the amended Contract pertaining to BA's submission of notice of bookings and review of BA's catering contracts by State Parks will further efforts on this issue.

Recommendation #4:

Verify that Bethpage is including all contract-related income in gross receipts when it calculates the license fee. Collect and remit the $14,421 in additional license fees it owes the State for 1999 and 2000. Recalculate the additional license fees that are due, and remit them to the State for prior and subsequent periods.

Response #4:

State Parks will investigate whether any "other" income received by BA should be subject to license fees. Historically, in interpreting and administering catering concession licenses, State Parks has not considered ancillary income, such as modest referral fees by contractors, interest income on deposits for events, etc. as part of gross receipts subject to a license fee. These relationships and ancillary income sources are inherent in the inner-workings of the catering business, and do not coincide with the common conception of what constitutes a sale for purposes of percentage rent. In the case of BA's catering operation, the income generated from ancillary sources represents a mere fraction of the overall sales revenue generated at the facility. Nevertheless, as this recommendation has statewide implications for our concession licenses involving the catering business, State Parks has referred this recommendation to Agency counsel for review, consideration and direction prior to taking further action or establishing policy.

Recommendation #5:

Follow up on the dates valet services were reportedly provided to Bethpage, where corresponding events were not listed on the catering log. Determine whether any income was not reported for those dates – and if so – recoup the appropriate license fee.

Response #5:

Please see Response #2 with respect to the reconciliation of reports. BA's utilization of valet parking services is not limited to catering affairs, and does not necessarily correlate to additional revenue-generating activities. On many occasions, BA makes valet parking available as an amenity to restaurant and other day-use park patrons, depending upon the demand for parking and State Parks' needs. Particularly through the years preceding the U.S. Open, many golf-related, media, and promotional events were held at Bethpage State Park. These events had the temporary effect of displacing the limited clubhouse parking available for day-use (golf and restaurant) patrons. Commencing in April 2002, traffic patterns in the Park were significantly changed, and clubhouse parking was severely impacted (restricted) by the staging and preparations for the U.S. Open. These preparations included the conversion of the tennis facilities into a merchandise facility and the establishment of a media center in the "ball field" parking area, both of which areas immediately adjoin clubhouse parking lots. To accommodate this loss of clubhouse parking, there were instances when valet parking services were retained by BA, but the service did not correspond to a catered event, or any event that would increase BA's sales volume. This was not unexpected. State Parks will continue to investigate this issue on the basis of the implication in the Report that there may have been unreported revenues, i.e. undisclosed catered events. However, no basis has been discovered on which to assert that BA failed to report revenues or that any license fees are owed. State Parks will be diligent in tracking this concern in the future, and new language in the amended Contract pertaining to notice of bookings and Agency review of BA's catering contracts will further that effort.

Recommendation #6:

Ensure Bethpage submits the required audited financial statements, and reconcile the statements to reported revenues.

Response #6:

State Parks will continue to require BA to submit audited financial statements on an annual basis. It is noted that BA's in-house controller is a certified public accountant and has been directly responsible for preparing and submitting financial statements in accordance with generally accepted accounting principles on behalf of BA. State Parks will reconcile these reports to reported revenues on a routine, interim audit basis. Notwithstanding this recommendation, it is believed that the OSC audit process has disclosed that BA has a fundamentally sound business office, and is running an effective and efficient business.

Report Findings: Capital Improvements

Recommendation #7:

Document Parks' review of all capital improvements made by Bethpage to date at Bethpage State Park.

Response #7:

The Report findings confirm that BA has substantially performed and exceeded its contractual capital investment commitment through the improvement of its licensed premises. These improvements are in service and have been a substantial factor in casting Bethpage State Park as a world-class facility.

All documentation of BA's capital expenditures available to the Agency was made available to OSC auditors. Due to the extensive work undertaken at Bethpage, the 2002 US Open, and the pending audits of all concession contracts at Bethpage, the Agency has not completed its comprehensive internal audit of BA's capital project, although this will occur. As set forth in the audit findings, BA has presented a gross capital expenditure of approximately $9.0 million. The audit findings confirm that BA negotiated settlements of capital debt worth a minimum of $6.1 million of which $4.8 million has been paid to date. While BA's $9.0 million in claimed expenditures likely includes some items that will not be technically allowed by State Parks as capital expenditures, at least $6.1 million is presumptively allowable, and represents an investment substantially in excess of Contract requirements.

Recommendation #8:

Monitor all future Parks projects to ensure that all Contract terms are complied with.

Response #8:

The Report comments on State Parks' oversight of BA's capital project in the clubhouse. It cannot be over-emphasized that BA undertook these substantial improvements simultaneously with the development of a shared vision for the renovation of a historic structure by multiple stakeholders. At least three separate interests pursued renovation projects in a structure served by shared infrastructure and common building systems. The vintage of the building gave rise to design challenges and field changes based on substantive historic preservation considerations. The final layout of the building evolved over time, in the process impacting the interests of BA, State Parks, and the golf concessionaire. Deteriorated structural elements, asbestos abatement, and complex code compliance issues were encountered routinely on site. These issues are documented in project records.

In addition, construction was undertaken within the unprecedented planning and implementation process required for the U.S. Open in June 2002. Many facility-based issues were not fully anticipated at the time BA's contract was awarded. Thus, while there was modification of the scope of the capital project, State Parks was actively involved in these decisions, which were made rationally given the information and circumstances at hand. Often, decisions on specific elements of projects were made by Agency personnel in the field on the basis of immediate cost-benefit considerations to ensure the best overall value to the State and prompt resumption and continuation of concession services for the public. Notwithstanding these tremendous challenges, as the Report acknowledges, BA's capital project was in fact completed on time.

With the amended Contract now approved, BA is in compliance with Contract terms. State Parks will ensure that all future capital projects are undertaken in accordance with the Contract and are properly administered and documented. The Agency will continue to work with BA to clarify expenses and documentation for its clubhouse project and any work not verified or supported by documentation will not be recognized.

Report Findings: Replacement & Refurbishment Account

Recommendation #9

Enforce Bethpage compliance with the Contract requirement to establish the R&R Account. Maintain the Account checkbook and verify that bank statements are being sent directly to Parks' Regional Office.

Response #9:

Agency records reflect that the replacement and refurbishment account ("R&R Account") was established by BA and that the Agency was indeed aware of its existence. However, funding for the R&R Account was necessarily interrupted when BA's business operation ceased during construction, and thereafter was held in abeyance in contemplation of the financial terms established for the amended Contract. The new financial terms relating to the R&R Account were pending approval throughout the course of the audit, and were critical to the ultimate resolution of all issues. In recognition of BA's enhanced capital investment, the approved amended Contract includes an appropriate credit for certain past and future R&R contributions. It bears noting that this credit represents completed renovations and improvements that are in service. Accordingly, BA is in compliance with funding obligation for R&R Account, and will be held accountable for the full value of all future accruals to the R&R account in accordance with the amended Contract. Likewise, State Parks will ensure that the account checkbook is maintained and bank statements are sent directly to State Parks' Regional Office

Recommendation #10

Ensure that Bethpage is depositing the required amount of funds into the R&R Account in a timely manner, bringing the account balance to its appropriate level, considering the relief granted on June 27, 2002.

Response #10:

Please see Response #9. Under the terms of the Contract as amended, BA is in compliance and there is currently no arrearage in R&R Account funding. State Parks will ensure that the R&R Account is properly funded and administered in accordance with the terms of the amended Contract.

Recommendation #11

Follow up on late or missed deposits immediately. Evaluate the need to impose a penalty assessment against Bethpage Associates whenever timely deposits are not made in the R&R Account.

Response #11:

BA is currently in compliance with Contract terms as amended, and there are no late or missing deposits. The Agency reserves the right to implement late charges in the future as a tool to aid in collection of the underlying amount due as set forth in the *Budget Policy and Reporting Manual (Item K-035: Waiver of Collection of Interest, Late Payment Charges, Collection Fee Charges, et seq.)* The *Manual* also authorizes State agencies to waive late charges when collection would not be administratively practical and cost-effective. As recommended, in the event of any future late payments or missing deposits on the part of BA, State Parks will evaluate and make the necessary determination of the appropriate course of action.

Recommendation #12

Obtain the budget and schedule of proposed expenditures that will be made when funds are withdrawn from the R&R Account. Require that all such expenditures be documented.

Response #12:

BA is in substantial compliance with Contract terms. The Agency has requested that BA submit a budget for any future (pre-planned) R&R Account expenditure. This recommendation must be balanced with the acknowledgment that one of the express purposes of the R&R Account is to create a source of readily accessible funds to address

unplanned occurrences, such as emergency repairs and the sudden or unexpected failure of equipment, which by definition, are not anticipated. The Agency will require that all R&R Account expenditures are documented in accordance with the Contract as amended.

Thank you for the opportunity to respond to the recommendations put forth by your staff in the Report.

Sincerely,

Christopher M. Pushkarsh

Christopher M. Pushkarsh
Director, Concessions & Contract Administration

cc.: Nancy Palumbo
J. Dennis Hanrahan
Paul Laudato, Esq.
Gail Berley