AUDIT REPORT

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

Audit Report on the Compliance of Merissa Restaurant Corporation With Its License Agreement

FM07-115A

June 6, 2008

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

WILLIAM C. THOMPSON, JR.
COMPTROLLER

To the Citizens of the City of New York

Ladies and Gentlemen:

In accordance with the responsibilities of the Comptroller contained in Chapter 5, §93, of the New York City Charter, my office has audited the compliance of the Merissa Restaurant Corporation (Merissa) with its license agreement with the Department of Parks and Recreation.

Merissa's agreement with the City permits Merissa to operate and maintain the Caffé-on-the-Green restaurant and catering facility in Bayside, Queens. We audit concessions such as this to ensure that private concerns under contract with the City comply with the terms of their agreements, properly report revenue, and pay all fees due the City.

The results of our audit, which are presented in this report, have been discussed with officials from Merissa and the Department of Parks and Recreation, and their comments have been considered in preparing this report. Their complete written responses are attached to this report.

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

Very truly yours,

William C. Thompson, Jr.

WCT/fh

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Filed: **June 6, 2008**

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AUDIT REPORT IN BRIEF

On January 8, 1990, the City of New York, through the Department of Parks and Recreation (Parks), entered into a 10-year license agreement with Café-on-the-Green Restaurant Corporation to operate and manage a restaurant, known as Caffé-on-the-Green in Bayside, Queens. On May 8, 1991, Café-on-the-Green Restaurant Corporation assigned its agreement to Merissa Restaurant Corporation (Merissa). On August 12, 1992, Parks extended the license agreement with Merissa to February 28, 2010.

Under the extended agreement, Merissa is required to pay a minimum annual fee and an additional 10 percent of gross receipts in excess of $750,000 in each operating year. In addition, each month Merissa is required to pay one-twelfth of the minimum annual fee. It is also required to post a security deposit with the City; maintain certain types and amounts of insurance coverage; submit statements of gross receipts and annual income and expense statement; and pay all utility charges and applicable taxes.

This audit determined whether Merissa accurately reported its gross receipts, properly calculated the license fees due, paid its license fees on time, and complied with certain other major non-revenue terms of the license agreement.

During operating years 2006 and 2007, Merissa reported $9,785,410 in gross receipts and paid $958,541 in license fees.

Audit Findings and Conclusions

Merissa paid its minimum annual fees on time, maintained the required liability insurance that named the City as additional insured party, maintained the required security deposit, and paid utility charges. However, significant weaknesses in Merissa's internal control procedures as well as a lack of supporting documentation prevented us from determining whether Merissa accurately reported all of its gross receipts from its restaurant and banquet operations and whether it paid the appropriate fees to the City. Specifically, Merissa:

- May have circumvented its point-of-sales system to misreport transactions;

- Did not provide banquet event calendars for calendar years 2005 and 2006 to evidence that all events held were represented by a properly authorized and executed contract and that all banquet revenue was reported to Parks;

- Does not maintain the point-of-sales system deletion reports for more than 10 days, which would have maintained an audit trail and allowed us to review whether any restaurant transactions were inappropriately deleted thereby reducing the revenue reported to Parks; and

- Could not provide a la carte party contracts to evidence that all a la carte parties were entered in the point-of-sales system. Merissa officials claimed that they discard these contracts a week after the events take place.

Taken as a whole, these weaknesses compromise the reliability of Merissa's reported gross receipts. However, based on the documentation provided, Merissa took $900,182 in improper deductions from gross receipts resulting in $120,607 in additional fees and related late charges due the City. Finally, Merissa did not submit its income and expense statements to Parks for operating years 2006 and 2007 within 30 days after the end of its operating year as required.

Audit Recommendations

Given the seriousness of the audit findings, we make nine recommendations—seven to Merissa concerning the operation of Caffé on the Green and two to Parks concerning the oversight of this concession. Compliance with these recommendations will ensure that Parks collects all license fees due; that controls over the operation are adequate for the recording of all gross receipts on Merissa's books and records and the accurate reporting of gross receipts to Parks; and that Parks more closely monitors Merissa's compliance with the terms of the agreement.

INTRODUCTION

Background

On January 8, 1990, the City of New York through Parks entered into a 10-year license agreement with Café-on-the-Green Restaurant Corporation to operate and manage a restaurant, known as Caffé-on-the-Green, in Bayside, Queens. On May 8, 1991, Café-on-the-Green Restaurant Corporation assigned its agreement to Merissa. The agreement required Merissa to renovate and maintain the existing structure of the restaurant and banquet rooms. On August 12, 1992, Parks, in conjunction with the City's Franchise and Concessions Review Committee, extended the license agreement with Merissa to February 28, 2010, due to Merissa's extensive renovation and additional capital investment.

Under the extended agreement, Merissa is required to pay a minimum annual fee of $60,000 ($5,000 per month) for operating years one to ten; $65,000 ($5,417 per month) for the operating years 11 to 15; and $70,000 ($5,833 per month) for operating years 16 to 18. In addition, Merissa is to pay an additional 10 percent of gross receipts in excess of $750,000 in each operating year. On or before the 10th of each month, Merissa is required to pay one-twelfth of the annual minimum fee; a 2 percent late charge is applied if fees are 15 days overdue. In addition, Merissa is required to post a $15,000 security deposit with the City; maintain certain types and amounts of insurance coverage; submit statements of gross receipts and annual income and expense statement; and pay all utility charges and applicable taxes.

During operating years 2006 and 2007 (March 1, 2005, to February 28, 2007), Merissa reported $9,785,410 in gross receipts, as shown in Table I, and paid $958,541 in license fees.

Table I

Schedule of Reported Gross Receipts
March 1, 2005, to February 28, 2007

Restaurant Gross Receipts	$5,452,013
Banquet Gross Receipts	4,333,397
Reported Gross Receipts	$9,785,410

Objectives

The audit's objectives were to determine whether Merissa:

- accurately reported gross receipts, properly calculated license fees due the City, and paid its license fees on time; and

- complied with certain other non-revenue terms of the license agreement (i.e., maintained the required security deposit, maintained the required insurance, and submitted the required reports).

Scope and Methodology

The scope of this audit was operating years 2006 and 2007 (March 1, 2005, to February 28, 2007). To achieve our audit objectives, we reviewed and abstracted the license agreement between Parks and Merissa. We also reviewed Parks correspondence, revenue reports, and other relevant documents. We analyzed the Parks concessionaire ledger for the amounts reported and paid to the City during our scope period, and determined whether payments were received on time. We also determined whether Merissa submitted monthly gross receipts reports and annual income and expense statements to Parks in a timely manner.

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

- interviewed Merissa's general manager, controller, banquet coordinator, and Certified Public Accountant;

- reviewed the manual for use of the restaurant's computerized point-of-sales system (Touch Pro);

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

- observed Merissa's processing of simulated transactions through its computerized point-of-sales system;

- conducted eight unannounced observations of its restaurant operation in January, April and August of 2007;

- conducted an unannounced observation of its banquet reservation process in May 2007; and

- documented our understanding of the operations through written narratives and flow charts.

To determine the accuracy of the reports generated from the Touch Pro point-of-sales computer system, we obtained the weekly revenue reports, daily payment detail reports, override logs, and all copies of guest checks retrieved from Touch Pro for the dates on which we conducted the unannounced observations, compared the information noted from the 12 guest checks (obtained during our observations) to the daily payment detail reports, and analyzed the results.

Since banquet event calendars for calendar years 2005 and 2006 were unavailable (as disclosed under the Scope Limitation section as well as in the Findings section of this report), we selected January and February 2007, with banquet gross receipts of $208,253, to determine whether Merissa accurately reported the gross receipts generated from the banquets. We obtained the banquet event calendar and banquet log, and compared the information to determine whether all banquet reservations recorded in the banquet event calendar matched the banquet log. We traced the banquet reservations to the banquet contracts to determine whether all banquets had written contracts, whether the contract forms used were sequentially numbered when they were printed, and whether they were distributed in consecutive order and uniform. We then traced the banquet revenue from the actual contracts to the general ledger and the gross receipt statements that were submitted to Parks to determine whether banquet revenue was accurately reported.

Finally, we ascertained whether Merissa complied with certain non-revenue terms of its agreement (i.e., posted the required $15,000 security deposit with the City, properly maintained insurance coverage, paid water and sewer charges and applicable taxes).

Scope Limitation

To conduct our audit of the license agreement between Merissa and the City, we requested specific data and documentation to ascertain whether Merissa reported all revenue and paid the City the appropriate fees. Merissa did not provide certain critical documents to support the amounts reported on the gross receipts statements submitted to Parks. Specifically, Merissa did not provide:

- Banquet event calendars for calendar years 2005 and 2006. These calendars are needed to determine whether all parties booked are represented by a written contract and whether all revenue related to these events was ultimately reported to Parks.

- A la carte party contracts for our scope period. A la carte party contracts are used for small parties held in the restaurant instead of in the banquet rooms. These contracts are needed to determine whether revenue from a la carte parties was entered into the point-of-sales system and ultimately reported to Parks.

- Deletion reports generated by Touch Pro. Deletion reports document restaurant orders that have been deleted from the point-of-sales system and identify the staff members who authorized the deletions. Without reviewing deletion reports, we are unable to determine whether orders were inappropriately deleted from the point-of-sales system with corresponding reductions in revenue reported to Parks.

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

Discussion of Audit Results

The matters covered in this report were discussed with Merissa and Parks officials during and at the conclusion of this audit. A preliminary draft report was sent to Merissa and Parks officials and discussed at an exit conference held on March 6, 2008. At the exit conference, Merissa provided additional documentation related to the issues discussed in this report. Upon reviewing the documentation, we made appropriate revisions to the report. On March 31, 2008, we submitted a draft report to Merissa and Parks officials with a request for comments. We received written responses from Parks and Merissa on April 14, 2008, and April 28, 2008, respectively.

Parks Response: In its response, Parks agreed with all of the Comptroller's audit recommendations. Parks officials advised us that a Notice to Cure has been issued requiring Merissa to pay the full audit assessment of $120,607 in additional license fees and late charges and has required Merissa to comply with the report's recommendations. Parks further responded that it "will monitor Merissa's operations and periodically audit their financial records to verify that Merissa is complying with all the internal control recommendations issued in the report."

Merissa Response: Merissa officials strongly disagreed with the report's conclusion that significant internal controls weakness over its restaurant and banquet operations existed and that the lack of supporting documentation prevented us from determining whether Merissa accurately reported all of its gross receipts from its restaurant and banquet operations and whether it paid the appropriate fees to the City.

Merissa officials claimed, "The finding by the Comptroller that Merissa circumvented its point of sale system to misreport transactions is contrary to sound audit principles. Specifically, the Comptroller's finding is based upon insufficient data, which makes this claim erroneous." The response further stated, "Had the Comptroller's office tested a larger sample, then the Comptroller would have found that Merissa's point of sale system works accurately. As per the prior Comptroller's audit, '…Merissa had adequate controls over the major components of its operations. In fact, our EDP auditors verified that Merissa's point of sale system and accounting software package are reliable and commonly used packages.'"

With regard to deletion reports, Merissa officials stated:

> "Merissa was unaware that these reports were automatically deleted after 10 days. When Merissa checked with its IT Company, Merissa was told these reports were deleted to ensure the system would run at peak efficiency and to save space. Merissa's accounting department checks and reviews transactions on a daily basis to ensure information is recorded accurately. There are other auditing techniques that the Comptroller's office could have used, which would have shown that Merissa accurately reported revenue from its restaurant operations. However, for reasons unknown to Merissa, the Comptroller's office chose not to utilize these alternate auditing methods, which would have shown that Merissa is accurately reporting revenue from its restaurant operations. Presently, Merissa prints the daily deletion reports and these reports are available to both the Comptroller's office and Parks."

With regard to maintaining a la carte contracts for purposes of documenting that all a la carte contracts were entered into the point-of-sale system, Merissa officials stated: "All a la carte parties were accurately reported into the point of sale system. The Comptroller's office did not reveal any underreporting of revenue."

Regarding the issue that Merissa did not provide banquet event calendars for 2005 and 2006, Merissa officials stated: "A banquet book was kept for the required time as recommended in our prior audit and discussed with the Comptroller's office and Parks as to its implementation. The Comptroller's audit did not reveal any underreporting of banquet revenue."

Auditor Comment: We continue to believe that the evidence is clear: Merissa does not have adequate internal controls over its restaurant and banquet operation to ensure that all gross receipts are properly recorded and reported to the City. The deficiencies are so severe that we could not perform detailed testing of Merissa's revenue to determine whether all gross receipts were actually reported. With regard to reporting revenue, we maintain that Merissa implemented a process which may have circumvented the controls described by management's response in order to misreport transactions within its restaurant and banquet operation.

The methodology we used to evaluate the effectiveness of those controls over restaurant operations is a sound and an established auditing practice. The evaluation of internal controls is a prerequisite to any audit testing, whereby auditors must first understand the policies and procedures established by the auditee's management to be able to assess the integrity and comprehensiveness of the information gathered by the accounting system for use in the auditee's internal and external financial reporting. Auditors are required to obtain an understanding of internal controls sufficient to determine the nature, timing, and extent of audit tests to be performed. Since we found that significant internal control weaknesses existed as well as a lack of supporting documentation, we concluded that we could not rely on the assertions made by management and therefore could not conduct any further analysis to determine whether Merissa accurately reported all of its gross receipts.

Merissa officials are being somewhat disingenuous in suggesting that an opinion from a prior Comptroller's audit, conducted nearly 12 years ago, would have the same relevance today as it had when issued. Moreover, Merissa officials are being both disingenuous and misleading in stating: "All a la carte parties were accurately reported into the point of sale system. The Comptroller's office did not reveal any underreporting of revenue." As previously mentioned, we could not determine whether Merissa properly reported a la carte party revenue because Merissa failed to retain the a la carte contracts that would have allowed us to trace whether revenue was being entered into the point of sales system and subsequently reported to Parks.

With regard to banquet revenue, we are dismayed by Merissa's response: "A banquet book was kept for the required time as recommended in our prior audit and discussed with the Comptroller's office and Parks as to its implementation. The Comptroller's audit did not reveal any underreporting of banquet revenue." Although we found that Merissa kept two sets of banquet books and calendars for 2007, Merissa provided no banquet event calendars for 2005 and 2006. Thus, Merissa's response does not refute our finding that we could not determine whether all banquet revenue was reported to Parks. Merissa simply refuses to accept the findings of this audit. It is for this reason that Parks must closely monitor Merissa's operations through the remainder of the contract period to ensure that the appropriate fees are paid.

The full texts of the responses received from Merissa and Parks are included as addenda to this report.

FINDINGS

Merissa paid its minimum annual fees on time, maintained the required liability insurance that named the City as additional insured party, maintained the required security deposit, and paid utility charges.

However, significant weaknesses in Merissa's internal control procedures as well as a lack of supporting documentation prevented us from determining whether Merissa accurately reported all of its gross receipts from its restaurant and banquet operations and whether it paid the appropriate fees to the City. However, based on the documentation provided, Merissa took $900,182 in improper deductions from gross receipts resulting in $120,607 in additional fees and related late charges due the City. Finally, Merissa did not submit its income and expense statements to Parks for operating years 2006 and 2007 within 30 days after the end of its operating year.

Significant Internal Control Weaknesses
Over Restaurant and Banquet Operations

Merissa does not have adequate internal controls over its restaurant and banquet operation to ensure that all gross receipts are properly recorded and reported to the City. The deficiencies are so severe that we could not perform detailed testing on Merissa's revenue to determine whether all gross receipts was actually reported. Specifically, Merissa:

- May have circumvented its point-of-sales system to misreport transactions;
- Did not provide banquet event calendars for calendar years 2005 and 2006 to evidence that all events held were represented by a properly authorized and executed contract and that all banquet revenue was reported to Parks;
- Does not maintain a la carte party contracts to evidence that all a la carte parties were entered into the point-of-sales system; and
- Does not maintain the point-of-sales system deletion reports for more than 10 days, which would have maintained an audit trail and allowed us to review whether any restaurant transactions were inappropriately deleted thereby reducing the revenue reported to Parks.

Taken as a whole, these weaknesses compromise the reliability of Merissa's reported gross receipts. Article IV of the agreement states that Merissa is required to:

> "Maintain adequate systems of internal control and shall keep complete and accurate records, books of account and data, including daily sales and receipts records, which shall show in detail the total business transacted by Licensee and the Gross Receipts therefrom. . . . All transactions shall be registered and recorded on accurate cash registers, totaling or computing machines or on other income-recording devices which shall register each transaction sequentially and contain

locked-in cumulative tapes with cumulative capacity satisfactory to Parks or Comptroller. . . . All reports and data generated from or by such machines and devices, including transactions, shall be posted daily on books and records of account. . . . Licensee shall maintain each year's records, books of account and data for a minimum of six (6) years."

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

Inadequate Controls over Restaurant Operation

Merissa does not have adequate internal control procedures over its restaurant operation to ensure that all gross receipts are properly recorded and reported to the City. Moreover, Merissa may have circumvented its procedures for recording revenue derived from its restaurant operation. Therefore, reports generated by the computerized point-of-sales system are not reliable. As part of our initial testing of the restaurant revenue, on January 28 and January 30, 2007, we sent two teams of two auditors (one team each day) to dine as customers at the restaurant and observe Merissa's restaurant operation. When we obtained the point-of-sales system weekly revenue reports, daily payment detail reports, and the copies of guest checks and compared them with the guest check information obtained during the observations, a cash expenditure of $85.07, including sales tax, made by one team was not included in the point-of-sales reports.

We then conducted six additional observations on various dates in April and August 2007 and obtained information from 10 guest checks. On April 5 and 13, 2007, two teams of two auditors (one team each day) dined at the restaurant and wrote down the information for their two guest checks. On April 18 and August 3, 2007, four teams of two auditors (two teams each day) ordered beverages at the bar and then dined at the restaurant. They either obtained the actual guest check, wrote down the guest check information, or took pictures of the guest checks. We did not have guest check information for one guest check at the bar because the bartender did not present the guest check to our auditors but merely stated the amount due. However, the auditors noted the items purchased and the amount paid and we subsequently verified that an entry for the items purchased and the amount paid were recorded on the point-of-sales system.

After we compared the guest check information with the point-of-sales reports, we found that one of the guest checks from the August 3, 2007, observation, totaling $83.72 including sales tax, was not included in the point-of-sales reports. In addition, although the revenue from the remaining nine guest checks was reported on the point-of-sales reports, the guest check numbers on three guest checks were different from the numbers the auditors wrote down. During the observations conducted on April 18, 2007, guest checks numbers 24, 28, and 37 were presented to our auditors. However, when we compared those numbers recorded on the point-of-sales system to the guest check information our auditors had written down, we found that the numbers did not match. The point-of-sales system reported our auditors' guest checks as 22, 26, and 35—an indication that at least two guest checks may have been deleted from the point-of-sales system.

Moreover, Merissa's point-of-sales system does not maintain deletion reports for more than 10 days. These reports are used to document orders deleted from the point-of-sales system and would have allowed us to identify the individual who authorized the deletions and to determine if sales were erroneously deleted. Consequently, we could not determine whether there were any other unusual activities in the restaurant operation during our scope period.

In addition, Merissa did not provide a la carte party contracts (contracts for small parties held in the restaurant instead of the banquet rooms) for our scope period. These contracts are not numbered. Therefore, there is no assurance that all the a la carte sales are actually recorded in the point-of-sales system and reported on the gross receipt statements submitted to Parks. Merissa officials said that they discard the a la carte contracts a week after the events take place. They claimed that all orders are entered into the point-of-sales system; therefore, it is not necessary to maintain a la carte contracts, a practice that is contrary to the requirement of the license agreement. However, without a la carte contracts, we were not able to trace a la carte party revenue to the point-of-sales system and determine whether Merissa reported its a la carte and restaurant revenue correctly.

Since 5 of 12 guest checks (41.7 percent) reviewed were not correctly reported on the point-of-sales reports, deletion reports are not maintained beyond 10 days, and a la carte party contracts are not numbered and are discarded, we concluded that Merissa's point-of-sales system is not reliable and that we would not perform any additional testing of the restaurant revenue based on any reports generated from the point-of-sales system.

Further, our review also identified other internal control weaknesses within Merissa's restaurant operation. Merissa's point-of-sales system does not generate sequential guest check numbers that carry over from one day to the next (i.e., guest check numbers start from "1" every day); a la carte party contracts are not sequentially numbered when printed; individual access codes are not assigned to its employees to operate the point-of-sales system; actual guest checks that were generated according to the dates of sales from the point-of-sales system are not maintained; Merissa does not reconcile the outstanding gift certificates recorded in the general ledger to the stubs maintained in the office. Without proper internal controls in place, Parks cannot be assured that all revenue from Merissa's restaurant operation is being accurately reported.

Lack of Documentation to Support Banquet Revenue

Merissa did not provide complete and accurate records of its banquet revenue that would have allowed us to trace the actual amount of banquet revenue collected and to determine whether Merissa reported all of its gross banquet revenue to Parks.

During a walk-through meeting with Merissa officials, they informed us that they did not use banquet event calendars for banquet reservations. They stated that when a customer wants to book a banquet, the banquet coordinator goes through the signed banquet contracts filed in the banquet coordinator's office to determine availability. However, when our auditors visited Merissa as perspective clients so as to observe the banquet reservation process, the banquet manager showed them a large red "2007 Banquet/Function Reservations" book (i.e., a banquet event calendar) with the name of the rooms printed on each dated page to check the availability of the rooms and dates.

Soon after our observation was conducted, we met with Merissa officials and requested that they provide the banquet event calendars for our scope period. However, Merissa officials insisted that they do not use banquet event calendars but maintain a "banquet log." The banquet log provided was a small generic diary that contained daily information, such as name of the party, contract number, number of patrons, initial deposit amount, location (room), and time. According to Merissa officials, the banquet information was recorded in the log after the banquets actually took place.

Since Merissa officials were not forthcoming in response to our request for a banquet event calendar, we told Merissa officials about our unannounced observation and that we knew a banquet event calendar was actually used. Soon thereafter Merissa officials provided the banquet event calendar for calendar year 2007, which was in use, claiming that the banquet manager was new and was using the 2007 banquet event calendar without their knowledge. However, we then asked Merissa officials to provide the 2005 and 2006 banquet event calendars, and they assured us that banquet calendars were not used during calendar years 2005 and 2006. Without performing a full reconciliation of contracts to banquet calendars for calendar years 2005 and 2006, we could not gain reasonable assurance that all parties booked were represented by a contract and that all banquet revenue was accurately recorded and reported on the gross receipt statements submitted to Parks.

Internal Control Weaknesses over Banquet Revenue

Since Merissa did not provide the banquet event calendars for calendar years 2005 and 2006, we could not ascertain whether Merissa reported all banquet revenue; however, we were able to perform testing on the banquet records provided for January and February 2007. Based on our review of documentation provided by Merissa (i.e., 2007 banquet event calendar, banquet log, banquet contracts, and general ledger), we identified 23 out of 66 events (34.8 percent) that had at least one recording irregularity. (Some events may have had more than one recording irregularity.) Table II shows the different types of irregularity we found.

Table II

Banquet Event Record Irregularities

Types of Irregularity	**Number of Irregularities**
Events without contracts	10
Events recorded on banquet event calendar but not on banquet log	12
Events recorded on banquet log but not on banquet event calendar	2
Banquet revenue that cannot be traced to the general ledger due to insufficient information	12
Banquet contracts used instead of a la carte contracts for parties held in the restaurant	7
Events not found into the point-of-sales system	3
Total Number of Irregularities	46

In addition, our review identified other internal control weaknesses within Merissa's banquet operation. Merissa does not record the banquet revenue in the point-of-sales system; lacks a daily payment log that records individual deposits made by customers; does not separately record deposits from a la carte and banquet customers; does not reconcile the banquet-event deposits to the banquet-event contracts; and lacks any written agreements for the commissions received from disc jockeys or florists. Without the proper internal controls in place, Parks cannot be assured that all revenue from Merissa's banquet operation is being accurately reported.

Improper Deductions from Gross Receipts

During operating years 2006 and 2007, Merissa reported $9,785,410 in gross receipts and paid $958,541 in fees. However, Merissa owes the City $90,018 in additional fees because it did not report gross receipts totaling $900,182 to Parks, as required by the license agreement.

Specifically, Merissa reported only $272,048 of the $756,237 in banquet gratuities (service charges) it received from banquet customers and improperly deducted $484,189 from gross receipts when calculating the monthly fees due Parks. The license agreement clearly does not allow for this type of deduction from gross receipts. §3.2(a) requires that "Gross Receipts shall include all funds received by Licensee without deduction or set-off of any kind, from the sale of food, wares, merchandise or services of any kind, resulting directly or indirectly from the operation of this license."

At our March 6, 2008 exit conference, Merissa officials stated that they were following the recommendations made in a prior Comptroller's report and believed that they should not be assessed any additional license fees or late charges for deducting a portion of gratuities from the gross receipts reported to Parks. Merissa officials further stated that had they been notified that the Comptroller's position had changed, they would have made the adjustment accordingly.

The Comptroller's prior audit report—FN96-171A dated December 20, 1996—found that Merissa had not fully distributed banquet gratuities to its wait staff, but had deducted the entire amount of gratuities charged to customers from gross receipts reported to Parks. That report recommended that Merissa should exclude from gross receipts only those banquet gratuities that customers gave for direct payment to banquet wait staff. However, our current research found that on June 1, 1995, the New York State Department of Labor Division of Labor Standards reformed regulation of banquet gratuities by issuing an opinion for Labor Law Section 196-d. That opinion stated,

> "Section 196-d provides that an employer may not accept, demand or retain any part of a gratuity, or charge purported to be a gratuity for an employee. There is an exception for 'practices in connection with banquets. . . where a fixed percentage of a patron's bill is added for gratuities which are distributed to employees.' It has been our past policy, when enforcing Section 196-d for banquets or other special functions, to require that, unless a service charge is clearly identified in writing as not being a gratuity, a fixed percentage service

charge to the patron must be distributed in its entirety to those employees who perform or render a personal service to the customer.

> "Effective immediately, service charges will not be considered gratuities. Service charges will be considered part of the gross receipts of the employer, and may be incorporated as part of the employer's wage obligation to employees. A service charge is not required to be distributed to employees."

Accordingly, Merissa should have complied with the terms of its agreement by not deducting banquet gratuities from gross receipts.

In addition, Merissa does not report the proceeds from customer deposits and gift certificates until the events have taken place or the gift certificates have been used. At the time of our review, Merissa accumulated $300,053 in deposits and $115,940 in gift certificates. §3.2(a) of the license agreement also states that gross receipts shall include "all receipts for services to be rendered." Consequently, Merissa should have reported customer deposits and gift certificate payments to Parks when payments were received.

As a result of the audit exceptions noted, Merissa owes $90,018 in additional fees as shown in Table III below.

Table III

Schedule of Additional Fees Due

Improper Deduction for Banquet Gratuities	$484,189
Unreported Deposits	300,053
Unreported Gift Certificates	115,940
Total Unreported Gross Receipts	$900,182
Applicable Percentage Fees	10 %
Additional Fees Due	**$90,018**

Late Charges of $30,589 Due the City

Article XXXV of the agreement with the City requires that Merissa pay the City late charges in accordance with the following:

> "In the event that payment of license fees, percentage fees or other charges shall become overdue for fifteen (15) days beyond the date on which it is due and payable as provided in this license, a late charge of two percent (2%) per month (computed on a thirty (30) day month) from the date it was due and payable on the sums so overdue shall become immediately due and payable to Commissioner as liquidated damages for the administrative cost and expenses incurred by Commissioner by reason of Licensee's failure to make prompt payment and said late charges shall be payable by Licensee without notice or demand. If the annual late fee and all arrears (including prior 2% charges) are not paid in full by the 10th

> day of the month following the month in which it shall be due, or is already past due, an additional charge of 2% of the total of such fee and arrears shall be added thereto and shall be payable and collectable with the next monthly license fee installment."

Based on the $90,018 in additional fees owed, we calculated that Merissa owes the City an additional $30,589 in late charges. (See Appendix for the calculation of late charges.)

Annual Income and Expense Statements Are Submitted Late and Are Inaccurate

Merissa did not submit its income and expense statements to Parks for operating years 2006 and 2007 in a timely manner. According to §3.4 of the agreement, Merissa is required to submit an annual income and expense statement within 30 days after the end of each operating year. Since Merissa's operating year ends on February 28, Merissa is required to submit an income and expense statement on or before March 30.

For operating years 2006 and 2007, the income and expense statements were not submitted until Parks issued Merissa a "Notice to Cure" dated June 16, 2006, and May 11, 2007, respectively. The income and expense statement for operating year 2006 was received on July 11, 2006—103 days beyond its due date, and the income and expense statement for operating year 2007 was received May 18, 2007—49 days beyond its due date.

Moreover, our review of the income and expense statements found that some expenses listed on the statements did not match the amounts recorded in the general ledger. The reconciliation worksheets prepared by Merissa's Certified Public Accountant (CPA) indicated that he was using estimated amounts when preparing the income and expense statements. For example, the cost of sales (an expense) listed on the 2007 income and expense statement was $150,000 more than that recorded in the general ledger. This overstatement would indicate to Parks that Merissa incurred a smaller profit due to inflated expenses. We question the CPA's judgment on using estimates rather than actual amounts. Without submitting an accurate income and expense report, Parks may have difficulty in accessing the actual income and expenses associated with operating this concession. Consequently, Parks will be prevented from determining a fair license fee to consider in future awards for this concession.

RECOMMENDATIONS

Given the seriousness of the findings noted in this report, Parks must take strong action to ensure that Merissa improves its operations. At a minimum, Parks should require Merissa to implement the following recommendations.

Merissa should:

1. Pay the City $120,607 in additional license fees and late charges.

***Merissa Response*: “**Merissa disputes that it owes the City ANY additional fees. The present finding by the Comptroller’s office that additional fees and late charges are due to the City is based on what appears to be a changed policy on the part of the Comptroller regarding the treatment of certain monies received by Merissa but which, prior to this audit, were not deemed to be part of gross revenues giving rise to the payment of license fees. Indeed, the present assessment involves items that the Comptroller’s staff approved and, in fact, instructed the licensee as to certain procedures to follow. The dispute arises because the Comptroller’s office now erroneously charges against Merissa an obligation to pay fees based upon Merissa’s collection of gratuities, which the Comptroller’s office categorizes as ‘service charges’ constituting revenues attributable to Merissa. However, Merissa does NOT collect service charges. Indeed, as had been clearly stated in the prior Comptroller’s audit ‘…Merissa SHOULD EXCLUDE [Emphasis in original.] banquet gratuities only from gross receipts that were collected from customers for direct payment to banquet wait staff.’ Merissa has followed the same practices since the inception of its operation of the licensed premises, and for over 16 years neither the Parks Department nor the Comptroller’s office has taken issue with the exclusion of gratuities collected by Merissa for its wait staff. In fact, the Parks Department as well as the Comptroller, as stated above, have endorsed this interpretation of gross revenues to exclude gratuities collected by the licensee and paid over to its wait staff. Whatever the Comptroller’s rationale for this changed policy regarding the treatment of gratuities collected by the licensee for the benefit of its staff, at a minimum, the application of this changed policy can only be prospective upon notice the licensee and cannot result in an assessment of license fees and interest for a period that preceded notice to the licensee of such changed treatment of gratuities. However, Merissa contends that even a prospective application of this policy is inconsistent with the definition of gross revenues in its license agreement.”

In regards to customer deposits and gift certificates, Merissa stated, “Customer deposits and gift certificates do not constitute sales or gross receipts. They are properly recorded as <u>liabilities</u> [Emphasis in original.] when deposited and only are reflected as sales when the actual sale occurs. In other words, they are not revenues to Merissa until such time as, in the case of a deposit, the event actually occurs or the customer cancels the event in breach of its agreement with Merissa, and, in the instance of a gift certificate when the certificate actually is used by its recipient. The foregoing is the only logical treatment of deposits and gift certificates because Merissa is only entitled to retain the money received on deposit or for the gift certificate under those circumstances. . . .The manner in which the Comptroller’s office seeks to treat customer deposits and gift certificates thus represents a changed interpretation of gross revenues, which is an interpretation that

Merissa contends is not supported by the provisions of its license agreement defining gross receipts."

In regards to late charges, Merissa stated that it "does not owe the City any additional fees. All fees were properly computed and paid timely; therefore there are no late charges due to the City."

Parks Response: In its response, Parks agreed with our assessment and stated that it issued a Notice to Cure requiring Merissa to pay the City the full assessment of $120,607.

Auditor Comment: We disagree with Merissa's contention that banquet gratuities are not service charges. A gratuity is a voluntary gift offered by customers to the wait staff. A service charge is a mandatory charge required by an establishment to be paid by customers. Although Merissa's banquet contracts indicate a separate charge for gratuities, these charges are calculated based upon a fixed percentage of fees. Thus, the fixed banquet gratuities are service charges as defined under the New York State Department of Labor Division of Labor Standards Section 196-d. That opinion states:

> "an employer may not accept, demand or retain any part of a gratuity, or charge purported to be a gratuity for an employee. There is an exception for 'practices in connection with banquets. . . where a fixed percentage of a patron's bill is added for gratuities which are distributed to employees.' It has been our past policy, when enforcing Section 196-d for banquets or other special functions, to require that, unless a service charge is clearly identified in writing as not being a gratuity, a fixed percentage service charge to the patron must be distributed in its entirety to those employees who perform or render a personal service to the customer.
>
> "Effective immediately, service charges will not be considered gratuities. Service charges will be considered part of the gross receipts of the employer, and may be incorporated as part of the employer's wage obligation to employees. A service charge is not required to be distributed to employees."

We therefore maintain that Merissa should not deduct banquet gratuities (service charges) from gross receipts.

With regard to customer deposits and gift certificates, it is clearly the intent of the license agreement that Merissa recognize patron payments, including deposits and gift certificates, upon receipt. The license agreement Article III, §3.2 (b), states that "gross receipts shall include sales made for cash or credit (credit sales shall be included in gross receipts as of the date of the sale) regardless of whether the sales are paid or uncollected, it being the distinct intention and agreement of the parties that all sums received by Licensee from all sources from the operation of this License Agreement shall be included in Gross Receipts." Consequently, Merissa's refusal to include in gross receipts the cash received from customer deposits and gift certificates is a violation of the license agreement. Based on this requirement, the revenue from deposits and gift certificates should have been included in gross receipts when received. Accordingly, we are satisfied that Parks has issued a "Notice to Cure" for license fees due on customer deposits and the sale of gift certificates for the total amount assessed by the auditors.

2. Take immediate actions to strengthen its internal controls, including but not limited to the following:

    - Install and maintain a reliable point-of-sales system;

Merissa Response**:** "Merissa maintains that their Point of sale system is reliable. They will however inquire as to upgrades to the system."

- Issue sequentially pre-numbered a la carte contracts;

Merissa Response**:** "Merissa has implemented this recommendation."

- Maintain all documentation, such as a la carte party contracts, original guest checks, deletion reports, and banquet event calendar (Banquet Function/Reservation book);

Merissa Response**:** "Merissa has implemented this recommendation."

- Record all banquet sales in the point-of-sales system; and

Merissa Response**:** "Merissa will contact their point of sale Company to inquire if the present system can accommodate this, and if not look for alternative ways to satisfy this recommendation."

- Maintain daily cash or check log detailing the individual deposit received or gift certificate sales transaction, as well as a copy of the checks.

Merissa Response**:** "Merissa has implemented this recommendation."

Parks Respons**e:** "Parks has also instructed Merissa to comply with Recommendations 2 through 7."

3. Ensure that for each banquet event listed in banquet event calendars a corresponding reference is made to the pre-numbered written agreement. This would ensure that all contracts and their corresponding deposit amounts are accounted for and would provide an independent means of tracing party contracts and revenue.

Merissa Response**:** "Merissa has implemented this recommendation."

4. Submit all signed banquet contracts (any contract whereby Merissa receives a deposit) and a monthly reconciliation detailing all banquet deposits to Parks through the remainder of the contract period.

Merissa Response**:** "Merissa will take this under advisement and discuss this issue directly with Parks."

5. Include all revenue receives from its operations in its gross receipts without deducting any portion of banquet gratuities (service charges) it receives from banquet customers.

Merissa Response**:** "Merissa strongly disagrees with this recommendation. These monies are not gross receipts or revenue. They are treated the same way as a la carte gratuities with the exception that in the event there is a remaining amount, it is kept by Merissa. Typically, this is a small percentage of the total and percentage fees have been submitted on this amount. Merissa proposes to continue to treat banquet gratuities consistent with the way they have for the past 16 years and in accordance with prior audit recommendations."

Auditor Comment: As documented in our finding and stated in the Auditor Comments under recommendation #1, the terms of the license agreement and the opinion of the New York State Department of Labor Division of Labor Standards clearly preclude deduction of fixed banquet gratuities from gross receipts. Merissa should reconsider its position on this matter.

6. Include in its monthly report of gross receipts submitted to Parks all payments (e.g., deposits and gift certificates) when they are received from patrons. Merissa should not wait until the date of the event to record the revenue received.

Merissa Response**:** "Merissa strongly disagrees with this recommendation. Merissa cannot include deposits and gift certificates as part of its revenue. Such a practice would be contrary to generally accepted accounting principles, which provides under the accrual method of accounting that revenue should not be reported until goods and services are actually provided. This recommendation would require Merissa to keep two set up financial records, incur significant costs and expose them to tax audits for improper accounting policies. Merissa proposes to continue, as it has for over 16 years, to treat all deposits and gift certificates as liabilities, until the event occurs."

Auditor Comment: It should be noted that the license agreement, not generally accepted accounting principles, defines what is included in gross receipts. The license agreement does not prohibit Merissa from recording its revenue in accordance with generally accepted accounting principles; however, it does require Merissa to comply with the terms of the license agreement when reporting gross receipts to Parks. Accordingly, Merissa should make appropriate adjustments.

7. Submit accurate annual income and expense statements to Parks within 30 days after the end of each operating year.

Merissa Response**:** "Merissa has implemented this recommendation and submitted their statement for the operating year ended February 29, 2008 by March 31, 2008."
Parks should also:

8. Issue a "Notice to Cure" to Merissa requiring that it pay $120,607 in additional license fees and late charges.

***Parks Response*:** Parks has already addressed this recommendation by issuing a "Notice to Cure" instructing Merissa to pay $120,607 in additional license fees and late charges.

9. Assign a Parks employee to closely monitor Merissa's operations through the remainder of the contract period to ensure that the appropriate fees are paid.

***Parks Response*:** "Parks will monitor Merissa's operations and periodically audit their financial records to verify that Merissa is complying with all of the internal control recommendations issued in the report."

APPENDIX

Period Ended	Due Date	Underreported Gross Receipts	Additional License Fees Owed (10%)	Accumulated Balance Due	Period From	To	Late Charge (2% per month)
02/28/06	03/10/06	$260,276	$26,028	$ 26,028	03/10/06	04/09/06	$ 521
				26,549	04/10/06	05/09/06	531
				27,080	05/10/06	06/09/06	542
				27,622	06/10/06	07/09/06	552
				28,174	07/10/06	08/09/06	563
				28,737	08/10/06	09/09/06	575
				29,312	09/10/06	10/09/06	586
				29,898	10/10/06	11/09/06	598
				30,496	11/10/06	12/09/06	610
				31,106	12/10/06	01/09/07	622
				31,728	01/10/07	02/09/07	635
				32,363	02/10/07	03/09/07	647
02/28/07	03/10/07	$639,906	$63,990	97,000	03/10/07	04/09/07	1,940
				98,940	04/10/07	05/09/07	1,979
				100,919	05/10/07	06/09/07	2,018
				102,937	06/10/07	07/09/07	2,059
				104,996	07/10/07	08/09/07	2,100
				107,096	08/10/07	09/09/07	2,142
				109,238	09/10/07	10/09/07	2,185
				111,423	10/10/07	11/09/07	2,228
				113,651	11/10/07	12/09/07	2,273
				115,924	12/10/07	01/09/08	2,318
				118,242	01/10/07	02/09/08	2,365
Total		***$900,182***	***$90,018***	***$120,607***			***$30,589***

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April 28, 2008

Via Hand

Hon. John Graham
Deputy Comptroller
Audits, Accountancy & Contracts
Office of the Comptroller
One Centre Street
New York, NY 10007-2341

Re: Merissa Restaurant Corporation
No. FM07-115A

Dear Deputy Comptroller Graham:

Pursuant to our understanding with your office, which extended to April 28, 2008, the time within which our client, Merissa Restaurant Corporation, was given the opportunity to furnish written comments regarding the Comptroller's Draft Audit Report, please find enclosed our client's response.

Your attention and consideration regarding the foregoing are appreciated.

Very truly yours,

Howard S. Weiss

Howard S. Weiss

HSW:nb

Enclosure

00373917

cc: Hon. Betsy Smith (Via Hand) (w/enc.)
Schulman Wolfson Pucci & Abruzzo, LLP
Merissa Restaurant Corporation

Response By Merissa Restaurant Corp. to City of New York Comptroller's Draft Audit Report, Dated March 2008, on the Compliance of Merissa Restaurant Corp. With Its License Agreement (Comptroller File No. FM07-115A)

Comptroller: Significant Internal control Weaknesses Over Restaurant and Banquet Operations

Comptroller: Merissa may have circumvented its point of sale system to misreport transactions

Merissa's response:

The finding by the Comptroller that Merissa circumvented its point of sale system to misreport transactions is contrary to sound audit principles. Specifically, the Comptroller's finding is based upon insufficient data, which makes this claim erroneous. The Comptroller's office used a sample of 12 guest checks in a total population of approximately 66,000 to base their findings. Ten out of the 12 guest checks were reported into revenue and two were not reported. To base an error rate of such a small sampling is both inaccurate and circumventing proper auditing guidelines. Had the Comptroller's office tested a larger sample, then the Comptroller would have found that Merissa's point of sale system works accurately. As per the prior Comptroller's audit, "...Merissa had adequate controls over the major components of its operations. In fact, our EDP auditors verified that Merissa's point of sale system and accounting software package are reliable and commonly used packages."

Comptroller: Merissa did not provide banquet event calendars for calendar years 2005 and 2006 to evidence that all events held were represented by a properly authorized and executed contract and that all banquet revenue was reported to Parks

Merissa's response:

A banquet book was kept for the required time as recommended in our prior audit and discussed with the Comptroller's office and Parks as to its implementation. The Comptroller's audit did not reveal any underreporting of banquet revenue. Merissa has implemented the use of banquet calendars and will keep them for the required time as per its license agreement.

Response By Merissa Restaurant Corp. to City of New York Comptroller's Draft Audit Report, Dated March 2008, on the Compliance of Merissa Restaurant Corp. With Its License Agreement (Comptroller File No. FM07-115A)

Comptroller: Merissa does not maintain the point of sales deletion reports for more than 10 days, which would have maintained an audit trail and allowed the Comptroller to review whether any restaurant transactions were inappropriately deleted thereby reducing the revenue reported to Parks

Merissa's response:

As stated to the auditors, Merissa was unaware that these reports were automatically deleted after 10 days. When Merissa checked with its IT Company, Merissa was told these reports were deleted to ensure the system would run at peak efficiency and to save space. Merissa's accounting department checks and reviews transactions on a daily basis to ensure information is recorded accurately. There are other auditing techniques that the Comptroller's office could have used, which would have shown that Merissa accurately reported revenue from its restaurant operations. However, for reasons unknown to Merissa, the Comptroller's office chose not to utilize these alternate auditing methods, which would have shown that Merissa is accurately reporting revenue from its restaurant operations. Presently, Merissa prints the daily deletion reports and these reports are available to both the Comptroller's office and Parks.

Comptroller: Merissa does not maintain a la carte contract to evidence that all a la carte parties were entered into the point of sale system

Merissa's response:

All a la carte parties were accurately reported into the point of sale system. The Comptroller's office did not reveal any underreporting of revenue.

Recommendation 1

Comptroller: Pay the City $120,607 in additional license fees and late charges.

Merissa's response:

Merissa disputes that it owes the City ANY additional fees. The present finding by the Comptroller's office that additional fees and late charges are due to the City is based on what appears to be a changed policy on the part of the Comptroller regarding the treatment of certain monies received by Merissa but which, prior to this audit, were not deemed to be part of gross revenues giving rise to the payment of license fees. Indeed, the present assessment involves items that the Comptroller's staff approved and, in fact, instructed the licensee as to certain procedures to follow. The dispute arises because the Comptroller's office now erroneously charges against Merissa an obligation to pay fees based upon Merissa's collection of gratuities, which the Comptroller's office categorizes as "service charges" constituting revenues attributable to Merissa. However, Merissa

Response By Merissa Restaurant Corp. to City of New York Comptroller's Draft Audit Report, Dated March 2008, on the Compliance of Merissa Restaurant Corp. With Its License Agreement (Comptroller File No. FM07-115A)

does NOT collect service charges. Indeed, as had been clearly stated in the prior Comptroller's audit "...Merissa SHOULD EXCLUDE banquet gratuities only from gross receipts that were collected from customers for direct payment to banquet wait staff." Merissa has followed the same practices since the inception of its operation of the licensed premises, and for over 16 years neither the Parks Department nor the Comptroller's office has taken issue with the exclusion of gratuities collected by Merissa for its wait staff. In fact, the Parks Department as well as the Comptroller, as stated above, have endorsed this interpretation of gross revenues to exclude gratuities collected by the licensee and paid over to its wait staff. Whatever the Comptroller's rationale for this changed policy regarding the treatment of gratuities collected by the licensee for the benefit of its staff, at a minimum, the application of this changed policy can only be prospective upon notice the licensee and cannot result in an assessment of license fees and interest for a period that preceded notice to the licensee of such changed treatment of gratuities. However, Merissa contends that even a prospective application of this policy is inconsistent with the definition of gross revenues in its license agreement.

Comptroller: Unreported deposits and gift certificates of $415,993

Merissa's response:

Customer deposits and gift certificates do not constitute sales or gross receipts. They are properly recorded as <u>liabilities</u> when deposited and only are reflected as sales when the actual sale occurs. In other words, they are not revenues to Merissa until such time as, in the case of a deposit, the event actually occurs or the customer cancels the event in breach of its agreement with Merissa, and, in the instance of a gift certificate, when the

certificate actually is used by its recipient. The foregoing is the only logical treatment of deposits and gift certificates because Merissa is only entitled to retain the money received on deposit or for the gift certificate under those circumstances. In the event, a party is cancelled by the patron and Merissa does not return their deposit, then the deposit is recorded as revenue and the appropriate fees are paid to the City. For the calendar years 2005 and 2006, Merissa has properly reported cancellation income of $8,850 and $9,050, respectively. Prior audits have correctly omitted any mention of customer deposits and/or gift certificates as they realize these are NOT revenue items. In this instance as well, the manner in which the Comptroller's office seeks to treat customer deposits and gift certificates thus represents a changed interpretation of gross revenues, which is an interpretation that Merissa contends is not supported by the provisions of its license agreement defining gross receipts.

Response By Merissa Restaurant Corp. to City of New York Comptroller's Draft Audit Report, Dated March 2008, on the Compliance of Merissa Restaurant Corp. With Its License Agreement (Comptroller File No. FM07-115A)

Comptroller: Late charges of $30,589 due to the City

Merissa's response:

In view of the above information, Merissa does not owe the City any additional fees. All fees were properly computed and paid timely; therefore there are no late charges due to the City.

Recommendation 2

Comptroller: Install and maintain a reliable point of sale system.

Merissa's response:

Merissa maintains that their Point of sale system is reliable. They will however inquire as to upgrades to the system.

Comptroller: Issue sequentially pre-numbered a la carte contracts

Merissa's response:

Merissa has implemented this recommendation.

Comptroller: Maintain all documentation, such as a la carte party contract, original guest checks, deletion reports, and banquet event calendar.

Merissa's response:

Merissa has implemented this recommendation.

Comptroller: Maintain daily cash or check log detailing the individual deposit received or gift certificate sales transaction, as well as a copy of the checks.

Merissa's response:

Merissa has implemented this recommendation.

Response By Merissa Restaurant Corp. to City of New York Comptroller's Draft Audit Report, Dated March 2008, on the Compliance of Merissa Restaurant Corp. With Its License Agreement (Comptroller File No. FM07-115A)

Comptroller: Record all banquet sales in the point of sale system

Merissa's response:

Merissa will contact their point of sale Company to inquire if the present system can accommodate this, and if not look for alternative ways to satisfy this recommendation.

Recommendation 3

Comptroller: Ensure that for each banquet event listed in banquet event calendars a corresponding reference is made to the pre-numbered written agreement.

Merissa's response:

Merissa has implemented this recommendation.

Recommendation 4

Comptroller: Submit all signed banquet contracts and a monthly reconciliation detailing all banquet deposits to Parks through the remainder of the contract period

Merissa's response:

Merissa will take this under advisement and discuss this issue directly with Parks.

Recommendation 5

Comptroller: Include all revenue received from its operations in its gross receipts without deducting any portion of banquet gratuities it receives from banquet customers

Merissa's response:

Merissa strongly disagrees with this recommendation. These monies are not gross receipts or revenue. They are treated the same way as a la carte gratuities with the exception that in the event there is a remaining amount, it is kept by Merissa. Typically, this is a small percentage of the total and percentage fees have been submitted on this amount. Merissa proposes to continue to treat banquet gratuities consistent with the way they have for the past 16 years and in accordance with prior audit recommendations.

Response By Merissa Restaurant Corp. to City of New York Comptroller's Draft Audit Report, Dated March 2008, on the Compliance of Merissa Restaurant Corp. With Its License Agreement (Comptroller File No. FM07-115A)

Recommendation 6

Comptroller: Include in its monthly report of gross receipts submitted to Parks all payments (e.g., deposits and gift certificates) when they are received from patrons. Merissa should not wait until the date of the event to record the revenue received

Merissa's response:

Merissa strongly disagrees with this recommendation. Merissa cannot include deposits and gift certificates as part of its revenue. Such a practice would be contrary to generally accepted accounting principles, which provides under the accrual method of accounting that revenue should not be reported until goods and services are actually provided. This recommendation would require Merissa to keep two set up financial records, incur significant costs and expose them to tax audits for improper accounting policies. Merissa proposes to continue, as it has for over 16 years, to treat all deposits and gift certificates as liabilities, until the event occurs.

Recommendation 7

Comptroller: Submit accurate annual income and expense statements to Parks within 30 days after the end of each operating year.

Merissa's response:

Merissa has implemented this recommendation and submitted their statement for the operating year ended February 29, 2008 by March 31, 2008.

City of New York
Parks & Recreation

Adrian Benepe
Commissioner

The Arsenal
Central Park
New York, New York 10065

Elizabeth W. Smith
Assistant Commissioner
Revenue and Marketing

(212) 360-1366
betsy.smith@parks.nyc.gov

April 14, 2008

BY FAX AND MAIL
Mr. John Graham
Deputy Comptroller
The City of New York
Office of the Comptroller
Executive Offices
1 Centre Street
New York, NY 10007

Re: Comptroller's Draft Audit Report on Merissa Restaurant Corporation March 1, 2005 through February 28, 2007 No. FM07-115A, Dated March 31, 2008

Dear Mr. Graham:

This letter represents the Parks Department's ("Parks"), response to the recommendations contained in the subject draft audit report ("the report") on Merissa Restaurant Corporation ("Merissa").

Parks has issued the attached "Notice To Cure" ("NTC") to Merissa requiring that it pay the City $120,607 in additional license fees and late charges ($90,018 in additional fees and $30,589 in late fees) as specified in **Recommendation 1**. Parks has also instructed Merissa to comply with **Recommendations 2** through **7.**

Recommendation 8, directed to Parks, has been addressed by issuance of the Notice to Cure to Merissa. In response to **Recommendation 9,** also directed to Parks, Parks will monitor Merissa's operations and periodically audit their financial records to verify that Merissa is complying with all of the internal control recommendations issued in the report.

Finally, we wish to thank the Comptroller's audit staff for their work and efforts in performing this review.

Sincerely,

Elizabeth W. Smith

cc: Comm. Adrian Benepe
Alessandro Olivieri
Laura Goebel
Walter Roberts
Jeffrey Kay, Mayor's Office of Operations

City of New York
Parks & Recreation

Adrian Benepe
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betsy.smith@parks.nyc.gov

April 14, 2008

BY FAX AND MAIL
Mr. Joseph Franco
Merissa Restaurant Corporation
201-10 Cross Island Parkway
Bayside, NY 11360

Re: NOTICE TO CURE
Comptroller's Draft Audit Report on Merissa Restaurant Corporation, March 1, 2005 through February 28, 2007 No. FM07-115A, Dated March 31, 2008

Dear Mr. Franco:

This letter addresses the findings and recommendations contained in the subject draft audit report ("the report") on Merissa Restaurant Corporation ("Merissa"). The report indicated that Merissa paid its minimum annual fees on time, maintained the required liability insurance that named the City as additional insured party, maintained the required security deposit, and paid utility charges.

However, the report disclosed that Merissa has significant weakness in internal control procedures as well as a lack of supporting documentation which prevented the Comptroller from determining whether Merissa accurately reported all of its gross receipts from its restaurant and banquet operations and whether it paid the appropriate fee to the City. Specifically, Merissa:

- May have circumvented its point-of-sales system to misreport transactions;
- Did not provide banquet event calendars for calendar years 2005 and 2006 to evidence that all events held were represented by a properly authorized and executed contract and that all banquet revenue was reported to Parks;
- Does not maintain the point-of-sales deletion reports for more than 10 days, which would have maintained an audit trail and allowed the Comptroller to review whether any restaurant transactions were inappropriately deleted thereby reducing the revenue reported to Parks; and

- Does not maintain a la carte contracts to evidence that all a la carte parties were entered into the point-of-sales system.

Parks agrees with the Comptroller's following recommendations:

Recommendation 1. Pay the City $120,607 in additional license fees and late charges. This payment is calculated as follows:

Table 1

Additional Fees Due	Amount
a. Improper Deduction for Banquet Gratuities	$484,189
b. Unreported Deposits	$300,053
c. Unreported Gift Certificates	$115,940
d. Total Unreported Gross Receipts	$900,182
e. Applicable Percentage Fee	10%
f. Subtotal: Additional Fees Due	$ 90,018
g. Late Charges	$ 30,589
h. Total: Additional Fees Due	**$120,607**

The auditors found that:

- During operating years 2006 and 2007, Merissa did not report gross receipts totaling $900,182 (line d) to Parks, as required by the license agreement.
- Of the total unreported gross receipts, $484,189 (line a) was from improperly deducted banquet gratuities (service charges). The deduction of gratuities from gross receipts is a violation of section 3.2(a) of the license agreement, which reads "Gross Receipts shall include all funds received by Licensee without deduction or set-off of any kind, from the sale of food, wares, merchandise or services of any kind, resulting directly or indirectly from the operation of this license." To reinforce this position, the Comptroller cited the New York State Department of Labor's Division of Labor Standards reformed regulation of banquet gratuities. The Division of Labor Standards issued an opinion for Labor Law Section 196-d on June 1, 1995. The opinion reads, "Effective immediately, service charges will not be considered gratuities. Service charges will be considered part of the gross receipts of the employer, and may be incorporated as part of the employer's wage obligation to employees. A service charge is not required to be distributed to employees."
- Additionally, Merissa does not report the proceeds from customer deposits and gift certificates when the event has not yet taken place. This practice violates section 3.2(a) of the license agreement, which states that gross receipts shall include "all receipts for services to be rendered." Over the audit period, Merissa accumulated $300,053 (line b) in unreported deposits for events and $115,940 (line c) in unused gift certificates

Recommendation 2. Take immediate actions to strengthen its internal controls, including but not limited to the following:

- Install and maintain a reliable point-of-sales system;
- Issue sequentially pre-numbered a la carte party contracts;

- Maintain all documentation, such as a la carte party contracts, original guest checks, deletion reports, and banquet event calendar (Banquet Function/Reservation book);
- Record all banquet sales in the point-of-sales system; and
- Maintain daily cash or check log detailing the individual deposit received or gift certificate sales transaction, as well as a copy of the checks.

Recommendation 3. Ensure that for each banquet event listed in banquet event calendars a corresponding reference is made to the pre-numbered written agreement. This would ensure that all contracts and their corresponding deposit amount are accounted for and would provide an independent means of tracing party contracts and revenue.

Recommendation 4. Submit all signed banquet contracts (any contract whereby Merissa receives a deposit) and a monthly reconciliation detailing all banquet deposits to Parks through the remainder of the contract period.

Recommendation 5. Include all revenue received from its operations in its gross receipts without deducting any portion of banquet gratuities (service charges) it receives from banquet customers.

Recommendation 6. Include in its monthly report of gross receipts submitted to Parks all payments (e.g., deposits and gift certificates) when they are received from patrons. Merissa should not wait until the date of the event to record the revenue received.

Recommendation 7. Submit accurate annual income and expense statements to Parks within 30 days after the end of each operating year.

Merissa should remit a check to Parks for the full amount within fifteen (15) days from the date of this Notice to Cure to resolve the balance presently owed under Recommendation 1. Furthermore, please be advised that in conjunction with a final recommendation by the Comptroller, Parks will closely monitor Merissa's future operations and periodically audit the company's financial records in order to ensure that Merissa pays appropriate fees and complies with all internal control recommendations.

We wish to thank Merissa for its anticipated compliance regarding implementation of all of the internal control recommendations discussed above and anticipate its remittance of the full amount payable.

Sincerely,

Elizabeth W. Smith

cc: Robert Garafola
Alessandro Olivieri
David Stark
Laura Goebel
Walter Roberts