

# AUDIT REPORT



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

## **Audit Report on the Fees Due from The USTA National Tennis Center, Inc., And the Center's Compliance With Its Lease Agreement**

*FM04-074A*

**October 19, 2005**



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 USTA National Tennis Center, Inc. (USTA) with the terms of its agreement with the New York City Department of Parks and Recreation.

Under the provisions of the agreement, the USTA is required to pay the City fees based on reported gross revenue for the exclusive use of the National Tennis Center, located in Flushing Meadows-Corona Park, 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 of the USTA and the Parks Department, 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](mailto:audit@Comptroller.nyc.gov) or telephone my office at 212-669-3747.

Very truly yours,

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

William C. Thompson, Jr.

WCT/fh

**Report: FM04-074A**  
**Filed: October 19, 2005**

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*The City of New York  
Office of the Comptroller  
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**AUDIT REPORT IN BRIEF**

On December 22, 1993, the City of New York through the Department of Parks and Recreation (Parks) entered into a 99-year lease with the USTA National Tennis Center Inc., (USTA) to “construct, renovate, maintain, manage and operate stadia and tennis courts for tennis activities.” The facility, in Flushing Meadows-Corona Park, Queens, consists of three stadia, indoor and outdoor tennis courts, a pro shop, restaurants, parking areas and administrative offices.

The lease gives USTA the exclusive right to use the facility and permits USTA to sell tickets, provide food and merchandise concessions, operate several restaurants and catering services for luxury and hospitality suites, provide parking and televised broadcasts, and enter into sponsorship and other advertising arrangements.

Under the lease, USTA is required to annually pay base rent of \$400,000 plus percentage rent—one percent of the gross revenue in excess of \$25 million that is derived directly from or in connection with the facility. For calendar year 2002, USTA reported approximately \$164 million in revenue and paid \$400,000 in base rent and approximately \$1.4 million in percentage rent to the City.

This audit determined whether the USTA accurately reported all gross revenue derived from the operation of the tennis center facility in accordance with the City lease agreement, paid the appropriate fees due the City timely, and complied with certain major non-revenue terms of the agreement.

**Audit Findings and Conclusions**

The USTA generally adhered to the provisions of its lease agreement with the City and had adequate controls over its revenue collection and reporting functions. In addition, the USTA paid the appropriate amount towards road and park improvements, maintained the required

property and liability insurance, paid water and sewer charges, and paid its rent on time. However, the USTA understated its revenue to the City by \$31,185,978. Consequently, the USTA owes the City \$311,860 in additional percentage rent as shown in Table I below.

**Table I**  
Schedule of Underreported Revenue and Additional Rent Due

<b>Underreported Revenue Category</b>	<b>Calendar Year 2002</b>	<b>Calendar Years 1996–2001</b>	<b>Calendar Years 2003–2004</b>	<b>Total Underreported Revenue</b>	<b>Additional Rent Due The City</b>
Broadcasting Revenue Offsets	\$1,410,139	\$7,140,156	\$2,954,651	\$11,504,946	\$115,049
Sponsorship Revenue	1,845,300			1,845,300	18,453
Additional Sponsorship Revenue	1,275,000	5,480,157	2,550,000	9,305,157	93,052
Hospitality Revenue	307,268			307,268	3,073*
Additional Sponsorship Benefits	2,220,918			2,220,918	22,209
Food Concession Additional Revenue		3,000,000		3,000,000	30,000*
Revenue Adjustments		3,002,389		3,002,389	30,024*
<b>TOTAL</b>	<b>\$7,058,625</b>	<b>\$18,622,702</b>	<b>\$5,504,651</b>	<b>\$31,185,978</b>	<b>\$311,860</b>

\* Subsequent to the issuance of the preliminary draft report USTA remitted a check totaling \$63,097 to the City for the additional rent due to underreported hospitality revenue, unreported food concession revenue, and prior-period revenue adjustments, leaving an unpaid balance of \$248,763.

Finally, USTA has not established guidelines for issuing and reporting complimentary tickets to the City. We believe that guidelines need to be established indicating the categories of entities and individuals who may receive complimentary tickets for which the value does not have to be included in revenue reported to the City.

**Audit Recommendations**

To address these issues, we recommend that USTA:

- Pay the City the remaining \$248,763 in additional percentage rent. (It should be noted that the draft report recommended that USTA pay the City \$270,852 due—\$248,763 in additional percentage rent and \$22,089 in late charges. However, based on additional information provided by USTA and Parks we eliminated the late charge from the assessment.)
- Report all National Tennis Center revenue, including the value of additional benefits received from sponsors, and sublicensee revenues to the City. These revenues should not be reduced by unallowable deductions.

- In conjunction with Parks, should establish guidelines for issuing and reporting complimentary tickets. The guidelines should establish categories of entities and individuals who may receive complimentary tickets for which the value does not have to be included in revenue reported to the City

We recommend that Parks:

- Ensure that USTA pays the City \$248,763 and complies with the report's other recommendations. (It should be noted that the draft report recommended that Parks ensure that USTA pays the City \$270,852—\$248,763 in additional percentage rent and \$22,089 in late charges. However, based on additional information provided by USTA and Parks we eliminated the late charges from the assessment.)

## INTRODUCTION

### Background

On December 22, 1993, the City of New York through the Department of Parks and Recreation (Parks) entered into a 99-year lease with the USTA National Tennis Center Inc., (USTA) to “construct, renovate, maintain, manage and operate stadia and tennis courts for tennis activities.” The facility, in Flushing Meadows-Corona Park, Queens, consists of three stadia, indoor and outdoor tennis courts, a pro shop, restaurants, parking areas and administrative offices. Each year, the USTA sponsors the US Open, an international professional tennis competition, at the facility.

The lease gives USTA the exclusive right to use the premises during “Tennis Event Periods.” During those periods, the lease permits USTA to sell tickets, provide food and merchandise concessions, operate several restaurants and catering services for luxury and hospitality suites, provide parking and televised broadcasts, and enter into sponsorship and other advertising arrangements. USTA may either operate or subcontract its food and merchandise operations at the facility; USTA chose to subcontract the facility's food and merchandise operations.

USTA is required to annually pay base rent of \$400,000 plus percentage rent—one percent of the gross revenue in excess of \$25 million that is derived directly from or in connection with the facility. USTA is also required to pay \$2.25 million for roadway improvements completed during construction of the facility and to contribute \$8 million towards park improvements. In addition, USTA is required to carry rent and liability insurance and pay water and sewer charges. For calendar year 2002, USTA reported approximately \$164 million in revenue and paid \$400,000 in base rent and approximately \$1.4 million in percentage rent to the City.

## **Objectives**

The objectives of this audit were to determine whether the USTA:

- accurately reported all gross revenue derived from the operation of the facility, properly calculated base and percentage rent, and paid the appropriate rents due the City on time; and,
- complied with certain other requirements of the agreement (i.e., maintained required insurance, paid its water and sewer charges, and paid the appropriate amount towards required road and park improvements).

## **Scope and Methodology**

The scope period of this audit was calendar year 2002. However, for certain areas in which we noted significant weaknesses, we extended our testing to include calendar years 1996 through 2001, and 2003 through 2004. To determine whether the USTA submitted the required statements and paid all rents on time, we reviewed records on file at Parks, including USTA's revenue reports and rent statements, insurance certificates, and correspondence between the USTA and Parks.

We evaluated the adequacy of USTA's internal controls over its revenue recording and reporting functions. To obtain an understanding of the USTA's operating procedures, we interviewed USTA officials, conducted a walk-through of the operations, observed US Open activities, and familiarized ourselves with USTA's accounting and record-keeping functions. We documented our understanding of the internal controls through written narratives. In addition, we consulted the Comptroller's General Counsel to obtain a legal opinion on the requirements for reporting all gross revenue and calculating percentage rent as outlined in the lease.

To determine whether USTA reported ticket sales accurately, we traced the reported ticket sales to the general ledger detail and to its computerized ticketing system (known as ARTICS). We evaluated the reliability of the reporting of revenue from ticket sales by performing tests of the controls on transactions generated by USTA's computerized ticketing system. For ticket revenue generated at the USTA's Box Office, we selected a judgmental sample of transactions for the week of August 26 through September 1, 2002 (the first week of the US Open and the week with most revenue activity). We traced the amounts from the summarized closing-sheet reports (prepared by each cashier at the Box Office) to the INC-A Reports generated by ARTICS.<sup>1</sup>

For tickets purchased through the mail (membership subscriptions), we traced the amounts on the individual batch detail reports to that listed on the daily deposits reports for

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<sup>1</sup> INC-A Reports summarize all daily transactions generated by the USTA box office.

calendar year 2002. We also reviewed all transactions listed in the Ticketmaster's<sup>2</sup> computerized advanced payment detail report and compared the weekly total of those amounts to the amounts on the ARTICS final sales report for accuracy.

To determine whether all ticket sale revenue was accurately and appropriately recorded, we traced the totals from the ARTICS final ticket sales report to the amount reported in the general ledger. We also reconciled the amount recorded on the daily ticket revenue deposit reports with the bank statements. We reviewed general ledger adjustments and estimates to determine whether transactions were reasonable and appropriate. In addition, we analyzed the ARTICS final ticket sales report and USTA's schedule of complimentary tickets to determine whether all complimentary tickets were appropriately accounted for and reported to the City.

To determine whether USTA reported all its revenue from sponsorship and broadcasting agreements, we reviewed each agreement and abstracted relevant terms and conditions, identified all gross sponsorship and broadcasting revenue, and traced reported sponsorship and broadcasting revenues to the amounts posted in USTA's general ledger. We then compared the amounts reported in the general ledger to the revenue reports submitted to Parks. In addition, we reviewed all revenue allocations (offsets) to determine whether the allocations were appropriate, properly classified, and accurately recorded. We analyzed additional benefits identified in the agreements (i.e., vehicle use, Web site development and maintenance, computer equipment, etc.) to determine whether they were assessed at their fair market value and whether their value was reported to Parks.

To determine whether USTA accurately reported revenue from luxury suites and hospitality, we compared the revenue reported to USTA's supporting schedules and general ledger entries. For merchandise sales, food concessions, and catering services, we reviewed USTA's sublicensee's annual sales report and compared those amounts to USTA's general ledger and to amounts that USTA reported to Parks. With regard to court rental income, we traced the amounts reported on USTA's daily cash register reports to the general ledger and compared that amount to the amount reported to Parks.

We examined USTA insurance policies, certificates of insurance, and we obtained independent verification from its insurance consultant to substantiate payment and compliance with specific policy requirements of the lease. To determine whether USTA paid the required water and sewer charges, we reviewed billing statements and copies of canceled checks.

To determine whether the City was appropriately reimbursed for the USTA's portion of road improvements associated with the construction of the facility, we reviewed USTA's 2002 financial statements and requested documentation that would confirm that full payment was remitted to the City.

Lastly, we determined whether USTA paid the City \$8 million for park improvements by reviewing the balances in a fiduciary account that was established to deposit these funds.

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<sup>2</sup> Our reliance on the Ticketmaster System was based on the representation made by Ticketmaster's independent auditors in their report dated January 25, 2002



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 USTA and Parks officials during and at the conclusion of this audit. A preliminary draft report was sent to USTA and Parks officials and was discussed at an exit conference held on June 9, 2005. On June 20, 2005, we submitted a draft report to USTA and Parks officials with a request for comments. We received written responses from Parks officials on June 23, 2005, and from USTA officials on June 27, 2005.

Although USTA agreed with certain aspects of our findings as evidenced by its response to specific sections of the audit report, it took exception to several matters and disagreed with the amount of our audit exceptions and assessment.

Parks issued a “Notice to Cure” to the USTA requesting payment of \$131,464 covering underreported sponsorship revenue, additional unreported benefits received from a sponsor, and additional unreported sponsorship benefits. Parks referred the remaining balance of \$117,299 to the City’s Law Department for resolution.

The specific issues raised by USTA and our rebuttals are included within the respective sections of this report. The full texts of the responses received from USTA and Parks are included as addenda to this report. Certain attachments to USTA’s response were too voluminous to include in this report. These documents are available for review at the Comptroller’s Office.

## FINDINGS

The USTA generally adhered to the provisions of its lease agreement with the City and had an adequate system of internal controls over its revenue collection and reporting functions. In addition, the USTA paid the appropriate amount towards road and park improvements, maintained the required property and liability insurance, paid the required water and sewer charges, and paid its rent on time. However, the USTA underreported its revenue to the City by \$31,185,978. Consequently, the USTA owed the City \$311,860 in additional percentage rent.<sup>3</sup>

Finally, USTA has not established guidelines for issuing and reporting complimentary tickets to the City. We believe that guidelines need to be established indicating the categories of entities and individuals who may receive complimentary tickets for which the value does not have to be included in revenue reported to the City.

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

### **Improper Deductions from Broadcast Revenue Totaling \$11,504,946**

#### **Calendar Year 2002: \$1,410,139**

USTA improperly deducted \$1,410,139 from its 2002 broadcast revenue on its revenue reports submitted to Parks. As a result, the USTA owes the City \$14,101 in additional percentage rent. According to the lease, USTA is required to “include, without limitation . . . revenues from direct, live, or taped broadcasting, in the United States and internationally of Tennis Events, whether by network, cable, tape delayed broadcast, pay per view or other device or system for contemporaneous viewing of Tennis Events.” USTA, however, reduced the amount of the broadcast revenue it received by deducting separate charges it paid for a “Host Broadcaster Service Fee” and other related expenses. Nothing in the lease allows for this deduction.

#### **Calendar Years 1996-2001: \$7,140,156; and Calendar Years 2003-2004: \$2,954,651**

As it did for calendar year 2002, USTA improperly deducted \$10,094,807 in Host Broadcaster Service Fees from broadcast revenue for calendar years 1996 through 2001, and 2003 through 2004. As a result, USTA owes the City \$100,948 in additional percentage rent in connection with the improper deductions taken in those years.

**USTA Response:** “The Comptroller’s audit determination is incorrect under Lease Section 3.03(d)(iii)(8) and is inconsistent with the GAAP financial reporting requirements imposed on the USTA under the Lease agreement with the City of New York. . . .

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<sup>3</sup> Subsequent to the issuance of the preliminary report, the USTA paid the City \$63,097 of the \$311,860 that was due, leaving \$248,763 in percentage rent still unpaid.

“The USTA has extensively explained to the Comptroller’s Office the pass-through Host Broadcaster Fee transaction. Nevertheless the Draft Audit incorrectly concludes that the USTA underreported \$11,504,946 in Gross Revenues over a period of nine years. The Host Broadcaster pass-through fee transactions involve payments by twenty-two (22) international TV sports broadcasters to the Host Broadcaster for services and expenses incurred by the Host Broadcaster in order to provide live TV transmission ‘feeds’ of U.S. Open Tennis Events. For reasons of convenience and efficiency, the USTA collects these fees and then credits or pays the amount collected to the Host Broadcaster.

“The finding of the Comptroller’s Office identifies payments received by the USTA for the account of the domestic Host Broadcaster as Gross Revenues despite the following facts:

- a. “Such payments are collected for the benefit of and credited to the Host Broadcaster, not the USTA.
- b. “The USTA receives cash on behalf of Host Broadcaster and pays it over to the Host Broadcaster. Therefore, the USTA receives zero revenue and keeps zero cash. The USTA is merely a conduit between the Host Broadcaster and the international broadcasters. Including such amounts in Gross Revenues would effectively overstate revenues.
- c. “Lease section 3.03(d)(iii)(8) specifically recognizes this type of pass-through payment transaction as Excluded Revenue which is not included in Gross Revenues.
- d. “Accordingly, the payments received on behalf of the Host Broadcaster should not be and are not recognized as revenue or Gross Revenue in the USTA’s Lease mandated GAAP financial reporting and certified audited financial statements.

“The Draft Audit’s determination does not comport with accounting principles applicable under the Lease. The Draft Audit’s determination, if followed, would incorrectly overstate Gross Revenues.”

**Auditor Comment:** USTA’s position regarding “pass-through payments” is not supported by §3.03(d)(iii)(8) of the lease, which clearly and unambiguously limits pass-through payments to subtenants. Pass-through payments made by subtenants for payment of real estate taxes, water rents, security deposits and utilities and other like pass-through payments are excludible. Section 10.01(b)(vii) of the lease defines a subtenant as “any party granted rights by Tenant [USTA] under a sublease or by any other Subtenant (immediate or remote) under a Sublease.” §10.01(vi) defines subleases as those that do not involve the conduct of operations related to tennis events. None of the issues raised by USTA have any connection to tenant-subtenant agreements and therefore cannot be construed to be a tenant-subtenant relationship as defined by the lease.

We agree that USTA is required by the lease to report its revenues and expenses on its financial statements in accordance with GAAP. This means that revenues and expenses should be recognized and reported in accordance with the accrual method of accounting. While this requirement is unrelated to our finding of broadcaster revenue not reported to the City, it calls into question the accuracy of the USTA's financial statements, since this revenue is not reflected on these statements.

**Underreported Sponsorship  
Revenue Totaling \$1,845,300**

USTA underreported its 2002 sponsorship revenue by \$1,845,300 as follows:

- USTA allocated \$695,200 of sponsorship revenue to a “non-US Open program” and excluded it from the amounts reported to the City. We could not determine the propriety of the transfer from the information provided by USTA.
- USTA deducted \$925,100 of sponsorship expenses from gross sponsorship revenue. This deduction is not allowable under the lease.
- USTA received and did not report to the City a \$225,000 sponsorship payment in 2002 for the 2003 US Open to be broadcast at Rockefeller Center. The agreement requires that the USTA record its revenue when received and pay the City the appropriate rent due.

Consequently, the USTA owes the City \$18,453 in additional percentage rent.

**USTA Response:** “The Draft Audit . . . incorrectly states that Sponsorship Revenue was underreported by \$1,845,300 and that the USTA owes the City \$18,453 as percentage rent (plus a late charge). . . . The Comptroller does not cite any relevant Lease provisions to support its findings. . . . No additional amount should be added to gross revenues; no percentage rent or late charge is due.

- a. “\$695,200 of Sponsorship Revenue allocated to USA League Tennis. The definition of ‘Excluded Revenues’ in Lease Section 3.03(d)(iii)(3) allows for the exclusion of ‘sponsorship or advertising revenue other than as described in clause [3.03(d)(ii)](3) from Gross Revenues.’ Clause ‘(3)’ refers to ‘revenues from sponsorship of Tennis Events and other advertising revenues **generated from the Project Site** and in connection with Tennis Events.’ [Emphasis added by USTA.]

“Pursuant to Lease Section 3.03(d)(iii)(3), the USTA allocated to USA League Tennis a fair value of fees received from two sponsors. Both of the underlying sponsorship agreements specifically state that the respective companies are ‘the’ sponsors for USA League Tennis nationwide tennis program, which has approximately 600,000 participants, operates on a year-round basis throughout the country, and is unrelated to the Project Site (the NTC) [the National Tennis

Center]. The value allocated to USA League Tennis was conservatively derived from industry standards. In this regard, the USTA has provided the Comptroller with additional documentation that demonstrate that the \$695,200 allocated to USA League Tennis is significantly less than the fair market value of similar sponsorships. In other words, its cost in the marketplace would greatly exceed the conservative valuation used by the USTA.

“The Draft Audit finding ignores both the explicit Lease provision that permits the USTA to allocate sponsorship fees to non-Project Site programs, as well as the marketplace information supplied by the USTA. The Comptroller’s determination that the USA League Tennis sponsorship has no value is invalid. The \$695,200 should not be included in Gross Revenues used to calculate rent payable to the City of New York.

- b. “Sponsorship Expenses of \$925,100. This amount was offset against sponsorship revenues because the USTA expended \$925,100 on items that it purchased on behalf of various sponsors. For example, the USTA purchases and installs signage throughout the NTC on behalf of its US Open sponsors. This service is one that the USTA is obligated to provide to such sponsors and the expenses associated with the service are paid for by a portion of the sponsorship fees. The USTA deducted the expenses incurred from the sponsorship revenues to correctly reflect the actual revenue received by the USTA. This amount was appropriately excluded from Gross Revenues.
- c. “Sponsorship Payment of \$225,000. This sponsorship payment was for a community event held at Rockefeller Center in 2003, whereby the USTA provided the general public with a free broadcast of the US Open as part of its mission to grow and promote the sport of tennis.

“As set forth in Section 3.03(d)(ii) of the Lease, Gross Revenues includes ‘gross rents, receipts, fees . . . accruals during the Lease Year . . . by or for the account of (x) Tenant, (y) USTA or any successor to the USTA that holds Tennis Events at the **Project Site** . . . from, in connection with, or directly or indirectly arising from activities existing from the **Project Site** and from the operation of the Premises. . . .’ [Emphasis added by USTA.]

“Revenue from this event at Rockefeller Center was appropriately excluded on a GAAP basis from Gross Revenues under the Lease because it was not from ‘the Project Site and from the operation of the Premises.’ Furthermore, the sponsorship payment to the USTA goes to fund the cost of staging the free public event.”

**Parks Response:** Parks responded that it “concur[s] with the first two audit findings of this section and requires that the USTA pay \$16,203. The third item covering the sponsorship payment for the ‘Off-Site’ broadcast will be . . . forwarded to the City’s Law department for legal review.”

**Auditor Comment:** Contrary to the USTA’s response, we are not ignoring the lease provision. Rather, we are questioning how the USTA calculated the \$695,200 deducted from gross receipts. Had the USTA provided adequate documentation, we would have allowed for this deduction. In this regard, the lease states:

“To facilitate the determination of what constitutes Gross Revenues, Tenant shall insure that all . . . contracts that it enters into related to . . . sponsorships and advertising revenues, shall, . . . expressly provide for fair allocations of Gross Revenues and Excluded Revenues.”

In addition, the USTA did not provide adequate documentation to support its claim that the “value allocated to USA League Tennis was conservatively derived from industry standards.”

Further, contrary to the USTA’s response, the lease does not allow the USTA to deduct expenses from gross revenue reported to the City. Finally, we disagree with the USTA’s contention that it could exclude the \$225,000 sponsorship payment in connection with broadcasting the US Open at Rockefeller Center. In that regard, the lease states that “revenues from direct, live or taped broadcasting, in the United States and internationally, of Tennis Events, whether by network, cable, tape delayed broadcast, pay per view or other device or system for contemporary viewing of Tennis Events, must be reported to the City.” Clearly, broadcasting the US Open in Rockefeller Center is no different than the types of broadcasting events mentioned in the lease.

Based on the above, we maintain that the USTA underreported sponsorship revenue by \$1,845,300 and owes the City \$18,453. In any case, we are pleased that Parks agreed with the first two audit findings, issued a Notice to Cure requiring payment of this portion of this audit assessment, and referred the issue of “Off-Site” broadcast to the City’s Law Department for review.

**USTA Did Not Report \$9,305,157  
In Benefits Received from a Sponsor**

**Calendar Year 2002: \$1,275,000**

USTA did not report on its revenue reports submitted to Parks \$1,275,000 in additional benefits that it received from one of its sponsors. Specifically, USTA did not report the value of technical support and Web site development and maintenance it received as part of one sponsorship agreement.<sup>4</sup> Consequently, USTA owes the City \$12,750 in additional rent. According to the lease, USTA must include the monetary value of all goods and services it receives in calculating its gross revenues.

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<sup>4</sup> The USTA could not determine the value of the technical support and Web site services provided by the sponsor under the 2002 agreement. Therefore, we based the value of these services on the 2003 agreement, which allowed up to \$675,000 for technical support and up to \$600,000 for Web site services.

**Calendar Years 1997-2001: \$5,480,157; and  
Calendar Years 2003-2004: \$2,550,000**

As it did for calendar year 2002, USTA did not report \$8,030,157 in additional benefits it received from sponsors for calendar years 1997 through 2001, and 2003 through 2004. As a result, USTA owes the City \$80,302 in additional rent.

**USTA Response:** “The Draft Audit . . . incorrectly concludes that the USTA received \$9,305,157 of value in sponsor benefits for services provided from 1997 through 2004, and that \$93,052 is due as additional rent. Based on the USTA’s extensive sports-related technical expertise and procurement experience involving world class tennis events, it has calculated the value of the sponsor provided services in question to be \$3,449,814, approximately one-third of the Draft Audit’s non-expert valuation. . . .

“The Draft Audit has incorrectly applied a ‘not to exceed amount’ clause in a 2003 sponsorship contract to determine the value of non-monetary services that it claims the USTA should have included in Gross Revenues. The ‘not to exceed amount’ represents the maximum possible value for services that the sponsor was willing to provide.

“Based on a substantially overstated ‘not to exceed’ valuation of the 2003 sponsorship contract services (\$1,275,000), the Draft Audit compounds the valuation error by attributing substantially the same value to sponsorship services in each of the eight (8) years from 1997 to and including 2004. The USTA, based on its industry knowledge and expertise, has estimated the value of the benefit received to be slightly above one-third (33%) of the amount included in the Draft Audit. Not only was it incorrect to apply a ‘not to exceed amount’ as the monetary for the services, it was incorrect to assume that the services provided in 2003 were substantially the same in each of the additional eight years included in the Draft Audit. Services received by USTA from sponsors have changed dramatically over the years particularly since 1997. Accordingly, the USTA disagrees with the ‘imputed’ amount claimed by the Comptroller’s office and has advised the Comptroller that the appropriate amount of \$3,449,814 should be included in Gross Revenues for the eight (8) year period. . . .

“As a result of the audit review process with the Comptroller’s Office, the USTA has concluded that it is appropriate to include in Gross Revenues reported under the Lease the correctly calculated estimated value of sponsor-provided services in question. In other words, the USTA concurs with the Draft Audit’s basic conclusion in this area. The USTA does not, however, concur with the Draft Audit’s erroneous valuation of these services.”

**Parks Response:** In its Notice to Cure, Parks stated that “the lease requires that the USTA must include the monetary value of all goods and services it receives in calculating its gross revenues. The USTA argued that the value for the benefit to the USTA was substantially less than the audit valuation. The auditors indicated that their calculation was based on the actual information noted in the sponsor’s contract with the

USTA. USTA officials mentioned that benefit amounts recorded in the contracts represented inflated estimates and that the true value received was much less. However, since there is no way to accurately calculate this item, Parks agrees with the Comptroller's assessment that is derived from specific information provided by the sponsor.

"Parks requires that the USTA pay the audit assessment in the amount of \$93,052 to resolve this item"

**Auditor Comment:** While USTA acknowledged its responsibility for reporting the value of benefits from sponsors in the gross revenue reported to the City, it is unclear how the USTA arrived at the amount stated in its response. Further, we question how the USTA's claim of "industry knowledge and expertise" pertains to valuation of technical support and Web site services provided a sponsor. As stated in the draft report, the value of the additional benefits was calculated based on amounts cited in the contracts between the USTA and its sponsor. In contrast, the USTA's response that its amount is based on their industry knowledge and expertise is not supported by any documentation. Therefore, we maintain that the USTA did not report \$9,305,157 and owes the City \$93,052 in fees. In any case, we are pleased that Parks issued a Notice to Cure requiring payment of this portion of this audit assessment.

### **USTA Underreported Hospitality Revenue by \$557,611**

Our review of the USTA's general ledger found that the USTA did not report \$557,611 in hospitality revenue to the City. According to the lease, gross revenues shall include "revenues generated by Hospitality Centers, luxury or VIP suites or lounges, etc., anywhere at the Premises." However, USTA did not report two hospitality payments totaling \$250,343 and improperly deducted \$307,268 in expenses from the amount reported to the City. Hospitality revenue is derived from packages sold for corporate functions. Each package may include a private area fully furnished with tables, chairs, food, beverages, and floral arrangements.

USTA officials paid the rent related to the non-reported hospitality revenue subsequent to our bringing this matter to their attention. USTA, however, did not address the \$307,268 in deducted expenses. Consequently, USTA still owes the City \$3,073 in additional rent.

**USTA Response:** "The USTA concurs with the Draft Audit's inclusion in Gross Revenues. . . of the \$307,268 in hospitality renewals and has accordingly paid \$3,073 as additional rent to the City of New York prior to the issuance of the Draft Audit."

### **USTA Did Not Report \$2,220,918 In Sponsorship Benefits**

Our review of the USTA's sponsorship agreements found that the USTA did not report \$2,220,918 for the estimated fair market value of goods and services it received in connection



with its sponsorship agreements in calendar year 2002.<sup>5</sup> Consequently, the USTA owes the City \$22,209 in additional percentage rent. According to the lease, USTA is required to pay one percent of gross revenues on “any and all gross rents, receipts, fees, proceeds, property, and amounts of any kind (and anything of monetary value) . . . from activities occurring at the Project Site and from operations of the Premises.” USTA did not report the estimated fair market value of the following sponsorship benefits:

- \$1,981,766 in free advertisements from several newspaper and magazine companies.<sup>6</sup> For example, the USTA required that a magazine sponsor provide, free-of-charge, 10 full pages of advertising in its daily newspaper plus two full four-page ads in its Sunday magazine in addition to the sponsorship fee. Moreover, the USTA offset its advertising expense by requiring other sponsors to purchase advertising space in leading sports magazines and other publications to promote the US Open.
- \$160,350 in goods from sport retailers and soft drink companies. The goods included 2,551 cases of soft drinks, 4,000 cases of bottled water, and 22 large refrigerators.
- \$78,802 in transportation, equipment and services. For example, in addition to a sponsorship fee, one sponsor provided the USTA with 100 vehicles for transportation service during the US Open.

While these types of arrangements are permitted under the City’s lease agreement, the fair market value of the goods and services received should be reported as revenue to the City, and USTA should pay the applicable percentage rent.

**USTA Response:** “The Draft Audit has incorrectly applied an inflated market value formula to determine the ‘benefits’ of certain goods and services received from USTA sponsors. Many of the perceived ‘benefits’ are clearly benefits and requirements of the involved sponsors (as reflected in the sponsorship fees) rather than benefits sought or required by the USTA. For example, refrigeration units provided by sponsors are typically a requirement of the vendor to sell their product. From the USTA’s point of view the value of these items, if any is, de minimis and accordingly they are not accounted for in the USTA’s annual financials; a determination agreed to by the USTA’s independent auditors.

“Notwithstanding the de minimis value of these types of items from a GAAP Accounting perspective, the USTA has agreed to allocate a Gross Revenue value to these ‘benefits’ based on the estimated cost to procure such items rather than the inflated list prices used in the Draft Audit. . . .”

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<sup>5</sup> The \$2.2 million does not include an amount for items for which a value could not be determined. These include the rental, shipping and programming costs for five electronic display boards; a multi-court scoreboard; and several plasma and LED information boards; and, a tri-state-New York area US Open based consumer promotion.

<sup>6</sup> \$1,981,766 was based on 40 percent of each publication’s rate card—the amount the USTA would have paid for these advertisements if the cost were not paid by the sponsors.

“While the specific items covered in the Draft Audit—hats, soft drinks, refrigerators, etc.—are mostly de minimis as a matter of financial accounting, it is not necessarily inappropriate to include the procurement-value of some of these items in Gross Revenues as the Draft Audit concludes. Clearly, some of the industry business practices and sponsorship transactions covered by the Draft Audit are ones that give rise to valuations about which reasonable financial and auditing professionals may differ. In this regard, the USTA is mindful that throughout the audit process the Comptroller’s representatives have concurred with various positions of the USTA, after initially concluding otherwise. In this instance it seems appropriate for the USTA to do likewise.

“The USTA believes that the value of these perceived benefits is de minimis, however, because the Comptroller’s office has taken the position that a value should be attributed to these items, the USTA concurs, but believes the correct value to be included (in) Gross Revenues is \$793,966 and the additional rent due is \$7,940.”

***Parks Response:*** In its Notice to Cure, Parks stated that it “has no way of verifying the exact value of goods and services provided to the USTA. However, the Comptroller’s methodology for calculating the amount of the benefits provided did allow for a significant discount to the applied estimated values. Also, as mentioned above the underreported total and audit assessment were reduced based on the additional information submitted by the USTA.

“Therefore, Parks agrees with the audit report on this item and requires that the USTA pay \$22,209 in additional rent.”

***Auditor Comment:*** Although the USTA acknowledges its responsibility for including the value of goods and services it received from sponsors in its reported gross revenues, we do not accept USTA’s estimate of the value of these items for several reasons. First, the major part of our finding deals with the provision of advertising by US Open sponsors. the value of which is not “de minimis” as claimed by USTA. USTA’s explanation of its valuation of advertising makes no sense considering the contract provisions between USTA and its sponsors. USTA claims that it receives only a 10 percent benefit from advertisements because its logo takes up 10 percent of the ad. However, the contracts require the sponsors to take out full-page advertisements in USTA’s magazines or to take out “US Open and tennis theme advertising and promotional activities” in private publications. Clearly, the value should be higher than that claimed by USTA.

Secondly, USTA’s estimates of the items provided by its sponsors were based on prices for less expensive, non-brand items instead of prices for those it actually received from its sponsors. That is, USTA provided Internet prices for generic hats, tennis shoes, etc., rather than prices for the name-brand items actually provided.

Finally, USTA’s response concerning the provision of refrigeration units is disingenuous in that it states that “refrigeration units provided by sponsors are typically a requirement of the vendor to sell their product.” The refrigerators provided by these vendors were to

hold the free soda and water provided to USTA's staff or US Open participants, not soda and water for sale to the public. In any case, we are pleased that Parks issued a Notice to Cure requiring payment of this portion of the audit assessment.

**USTA Did Not Report \$3,000,000 Received from a Sublicensee**

During calendar year 1998, USTA entered into an agreement with a sublicensee to provide food and other services for USTA during certain periods of the US Open. In consideration for USTA's entering into this agreement, the sublicensee paid USTA \$3,000,000, which USTA did not report to the City. §3.03(d)(II)(11) of the agreement states that "revenues . . . in connection with the use, occupation or operation of the Project Site, including without limitation, concessions, licenses or agreements granted to third parties in connection with the providing of any such goods or services" must be reported to Parks.

The agreement between the USTA and the sublicensee disclosed that the sublicensee was required to make two payments totaling \$3,000,000 to the USTA before beginning operations at the facility. USTA included the first payment on its second quarterly revenue report for 1998, but subsequently deducted the amount from its third-quarter revenue report. In addition, the third-quarter revenue report did not include the sublicensee's second payment. As a result USTA owes the City \$30,000.

***USTA Response:*** "The USTA concurs with the Draft Audit's inclusion in Gross Revenue. . . of the \$3,000,000 payment in 1998 by a food sublicense and has accordingly paid \$30,000 as additional rent to the City of New York prior to the issuance of the Draft Audit."

**Prior Period (1999-2001) Revenues Were Understated by \$3,002,389, Resulting in \$30,024 in Additional Percentage Rent Owed**

USTA underreported its revenue for 1999 to 2001 on its revenue reports submitted to the City by \$3,002,389. According to §3.03(b) of the lease agreement, "Tenant shall pay Percentage Rent . . . based on Gross Revenues as set forth in quarterly statements furnished by Tenant to Landlord pursuant to §28.01(a), with adjustment in accordance with §3.03(c), if necessary, after submission of audited, certified financial statements by the Tenant to the Landlord." Furthermore, §3.03(c) states that "if any installment of Percentage Rent has been underpaid by Tenant, Tenant shall pay the amount of such underpayment."

Our review of the revenue reported to the City for 1999, 2000, and 2001 revealed that the amounts reported on USTA's certified financial statements was \$3,002,389 higher than the amounts reported to the City. Specifically, for calendar years ending December 31, 1999, 2000, and 2001, USTA underreported revenue by \$897,420, \$1,764,527, and \$340,442 respectively. Therefore, USTA owes \$30,024 in additional rent as shown in Table II on the next page.

**Table II**  
Schedule of Underreported Revenue and Additional Percentage Rent Due  
(1999-2001)

<b>Year</b>	<b>Amount Reported on Revenue Reports</b>	<b>Amount Reported on the USTA Financial Statements</b>	<b>Unreported Difference</b>	<b>Percentage Rent Owed</b>
1999	\$125,998,128	\$126,895,548	\$897,420	\$8,974
2000	\$138,306,923	\$140,071,450	\$1,764,527	\$17,645
2001	\$154,287,558	\$154,628,000	\$340,442	\$3,404
<b>TOTAL</b>	<b>\$418,592,609</b>	<b>\$421,594,998</b>	<b>\$3,002,389</b>	<b>\$30,024</b>

**USTA Response:** “The USTA concurs with the Draft Audit’s inclusion in Gross Revenues. . . of a total of \$3,002,389 for the years 1999, 2000, and 2001 and has accordingly paid \$30,024 as additional rent to the City of New York prior to the issuance of the Draft Audit.”

**Other Issue**

USTA issued complimentary tickets to USTA staff, tennis event participants, support personnel, media groups, sponsors, marketing corporations, among others. While we do not question USTA’s decision to issue complimentary tickets as part of its business operations, we believe that guidelines need to be established indicating the categories of entities and individuals who may receive complimentary tickets for which the value does not have to be included in revenue reported to the City. It should be noted that since the lease does not address this issue and Parks has not established any guidelines in this area, we did not include the value of complimentary tickets in our calculation of additional fees due.

**RECOMMENDATIONS**

We recommend that USTA:

1. Pay the City the remaining \$248,763 in additional percentage rent. (It should be noted that the draft report recommended that USTA pay the City \$270,852 due—\$248,763 in additional percentage rent and \$22,089 in late charges. However, based on additional information provided by USTA and Parks we eliminated the late charges from the assessment.)

2. Report all National Tennis Center revenue, including the value of additional benefits received from sponsors and sublicensee revenues, to the City. These revenues should not be reduced by unallowable deductions.

**USTA Response:** As discussed earlier, USTA officials took exception with broadcast and sponsor revenue and benefits, but did not specifically address the audit’s recommendations.

3. In conjunction with Parks, should establish guidelines for issuing and reporting complimentary tickets. The guidelines should establish categories of entities and individuals who may receive complimentary tickets for which the value does not have to be included in revenue reported to the City.

**USTA Response:** “This subject is not covered in the Lease and as a result, in the course of the audit process both the USTA and the Comptroller’s representatives concluded that there could be a need for greater clarity as to which categories of such tickets, if any, might have an imputed value that should be included in Gross Revenues. As a result, the USTA and Parks Department have already agreed to discuss this matter further and to seek guidance from the City’s Corporation Counsel.”

We recommend that Parks:

4. Ensure that USTA pays the City \$248,763 and complies with the report’s other recommendations. (It should be noted that the draft report recommended that Parks ensure that USTA pays the City \$270,852—\$248,763 in additional percentage rent and \$22,089 in late charges. However, based on additional information provided by USTA and Parks we eliminated the late charges from the assessment.)

**Parks Response:** Parks responded that it: “has issued the attached ‘Notice To Cure’ (‘NTC’) to the USTA requesting payment under **Recommendation 1** for the partial amount of \$131,464 covering the following audit categories:

“Underreported Sponsorship Revenue	\$ 16,203
Additional Unreported Benefits received from a Sponsor	93,052
Additional Unreported Sponsorship Benefits for Goods and Services	<u>22,209</u>
<b>TOTAL AMOUNT BILLED</b>	<b><u>\$131,464</u></b>

“The remaining principal balance of \$117,299 is being referred to the City’s Law Department for resolution. The items requiring legal review are:

“Improper Deductions from Broadcast Revenue	\$115,049
Sponsorship Payment for broadcast of the US Open at Rockefeller Center	<u>2,250</u>
<b>AMOUNT TO BE REFERRED TO CITY’S LAW DEPARTMENT</b>	<b><u>\$117,299</u></b>

“In Reviewing Appendix I of the audit report covering the ‘Late Charge’ component, \$22,089, of Recommendation 1, we calculated that the stated ‘Amount Underpaid’ was

less than five percent (5%) of the ‘Adjusted Revenue.’ The lease requires that an underpayment must exceed 5% for a late charge to apply. Therefore, Parks did not bill the USTA the \$22,089.

“To comply with **Recommendation 2**, the NTC required that the USTA implement the necessary accounting procedures to ensure that all revenue including the value of all benefits received from its sponsors is reported to the City. **Recommendation 3** suggests that the USTA in conjunction with Parks should establish guidelines for issuing and reporting complimentary tickets. Although the Lease does not provide any restrictions for issuing and reporting complimentary tickets to the City, Parks appreciates the Comptroller’s concern and comments on this subject. Parks will consult with the City’s Law Department in this matter and if feasible, will coordinate with the USTA to implement a guideline for complimentary tickets.” [Emphases in original.]



UNITED STATES TENNIS ASSOCIATION

June 27, 2005

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White Plains, NY 10604  
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IMMEDIATE PAST PRESIDENT

Alan G. Schwartz

EXECUTIVE DIRECTOR & COO

D. Lee Hamilton

Dear Mr. Brooks:

Enclosed with this letter is the USTA's response to the Comptroller's June 20, 2005 "Draft Audit Report on the Fees Due from The USTA National Tennis Center, Inc., And the Center's Compliance With Its Lease Agreement" (the "Draft Audit").<sup>1</sup> The USTA received the Draft Audit on June 20, 2005, following the June 9, 2005 exit conference with the Comptroller's Office.

In 2001, the Comptroller's Office issued a joint release with the USTA recognizing that the US Open generated more in direct revenue to the tri-state area than any other annual sports or entertainment event in any city in the United States. In July 2003, when we were notified of this audit, we were naturally pleased to have the opportunity to demonstrate the benefits of that revenue flowing directly to the City of New York, which we are extremely proud to call the home of the USTA National Tennis Center ("NTC") and the US Open. By way of example, in the last 11 years, US Open revenue has grown by approximately 500%, and in turn, rent paid to the City of New York by USTA NTC has gone from \$320,000 in 1994 to \$2.02 million in 2004 – a 630% increase.

Since this audit was initiated, we have engaged in a professional, courteous and detailed exchange with the Comptroller's Office and we sincerely appreciate the time and effort devoted to this audit by the Comptroller's staff. As an organization, the USTA is committed to transparency and compliance with the letter and spirit of the USTA NTC Lease. We are very pleased that this commitment was recognized by the Comptroller's Office, which found that "The USTA generally adhered to the provisions of their lease agreement with the City and had adequate controls over their revenue collection and reporting functions. In addition, the USTA paid the appropriate amount towards road and park improvements, maintain[ed] [sic] the required property and liability insurance, paid water and [se]wer[er] [sic] charges, and paid its rent on time." (Draft Audit, p. 2).

Despite this important and accurate finding, and despite the narrowing of certain differences between our organizations on select issues, there nonetheless remain important disparities on several significant matters in the Draft Audit. While the Comptroller's Office is of the view that \$31,185,978 should be considered additional gross revenue reportable under the Lease governing the USTA NTC, the USTA's view is that only \$10,553,437 of that amount constitutes gross revenue reportable under the Lease. Although our differences with the Draft Audit are significant in a number of respects, we view those differences as ones between reasonable partners in a remarkably successful and mutually beneficial joint venture since its inception in August 1978, upon the completion of the NTC in Flushing Meadows-Corona Park.

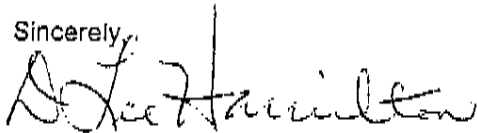
<sup>1</sup> The United States Tennis Association Incorporated, a 501(c)(6) tax exempt organization ("USTA"), is the sole member of the USTA National Tennis Center Incorporated, a 501(c)(3) tax exempt organization ("USTA NTC"). In 1993, the USTA NTC entered into a 99-year lease with the City of New York to construct, renovate, maintain and operate the USTA National Tennis Center in Flushing Meadows-Corona Park.

At that time, the USTA and the City of New York embarked on an extraordinary, long term journey that has defied the well known trends of tax breaks, concessions and the use of municipalities as bargaining chips to select the city a sports entity calls "home". Nearly three decades removed from its opening, the NTC remains one of, if not "the", greatest and most unique venues in the country. In addition to hosting the US Open (the world's largest annually attended sporting event), the NTC serves as the world's largest public tennis facility, open to the public 11 months of the year. The NTC also represents a rare example of a world class sports venue that currently pays approximately \$2 million in municipal rent each year despite the fact that it was constructed without the use of any taxpayer money – a win-win for the USTA and the people of New York City.

Over the years, the USTA has invested hundreds of millions of dollars in the NTC. Our biggest investment to date made its debut in 1997 with the opening of Arthur Ashe Stadium – the crown jewel of the NTC and a court that has played host to some of the greatest tennis matches of all time, each seen in person by 20,000+ spectators and viewed by worldwide television audiences that have exceeded tens of millions of people. Since 1994, the USTA has spent more than \$344 million renovating and improving the NTC – including the construction of Arthur Ashe Stadium. No City money has been required or requested. Our approach to stadium construction was so unique that Mayor Bloomberg acknowledged in 2002 that it was "the only good athletic sports stadium deal, not just in New York, but in the country." The same has been true of our approach to the balance of the facility – including the 33 public tennis courts now in use at the NTC, each of which was paid for by the USTA.

We are confident that our commitment to this City is also reflected in the considered analysis we conducted in connection with the Comptroller's Draft Audit. Our position is outlined in the attached USTA National Tennis Center's Principal Corrections and Concurring Responses. We thank you in advance for your review.

Sincerely,



D. Lee Hamilton  
Executive Director & COO

Attachment

cc: William C. Thompson, Jr.; Comptroller,  
The City of New York, Office of the Comptroller  
Michael Morgese; Assistant Director,  
The City of New York, Office of the Comptroller  
Adrian Benepe; Commissioner,  
New York City Department of Parks & Recreation  
Joanne G. Imohiosen; Assistant Commissioner for Revenue,  
New York City Department of Parks & Recreation  
Arlen Kantarian; Chief Executive, Professional Tennis, USTA  
Jared F. Bartie; General Counsel & Chief Legal Officer, USTA  
Sonja Espinal; Chief Financial Officer & Director of Administration, USTA





**USTA NATIONAL TENNIS CENTER'S  
PRINCIPAL CORRECTIONS  
AND  
CONCURRING RESPONSES**

**Respecting:**

**COMPTROLLER'S JUNE 20, 2005 DRAFT AUDIT REPORT ON THE FEES DUE  
FROM THE USTA NATIONAL TENNIS CENTER, INC.,  
AND THE CENTER'S COMPLIANCE WITH ITS LEASE AGREEMENT**

June 27, 2005

\*\*\*\*\*

The United States Tennis Association Incorporated, a 501(c)(6) tax exempt organization ("USTA"), is the sole member of the USTA National Tennis Center Incorporated, a 501(c)(3) tax exempt organization ("USTA NTC"). In 1993, the USTA NTC entered into a 99-year lease with the City of New York to construct, renovate, maintain and operate the USTA National Tennis Center in Flushing Meadows-Corona Park.

**I. INTRODUCTION: THE COMPTROLLER'S JUNE 20, 2005 DRAFT AUDIT'S PRINCIPAL CONCLUSION CONFIRMS USTA LEASE COMPLIANCE; IMPORTANCE OF USTA'S NATIONAL TENNIS CENTER (NTC).<sup>1</sup>**

Nearly two years ago in July of 2003, the City of New York Comptroller's Office ("Comptroller's Office") commenced an extensive audit of the USTA NTC principally regarding the USTA NTC's compliance with its obligations under the 1993 City of New York-USTA NTC 99-year lease ("Lease") requiring payment of base rent and Gross Revenues percentage rent to the City of New York's Department of Parks & Recreation ("Parks Department") for revenue producing USTA tennis events (e.g., the US Open), while occupying and using the City-owned NTC facilities and related Flushing Meadows-Corona Park land. On June 9, 2005, a formal audit "exit conference" was convened by the Comptroller's Office and attended by representatives of the Comptroller's Office, the Parks Department, the City of New York and the USTA. On Monday June 20, 2005, the Comptroller's Office issued a final draft audit ("Draft Audit"), attached hereto at tab 1, as to which the Parks Department and USTA were requested to submit written comments, if any, by close of business on Monday June 27, 2005.

On June 23, 2005 the Parks Department issued a Notice To Cure addressed to the USTA, attached hereto at tab 2, which set forth its responses to specific determinations and recommendations in the Draft Audit. Significantly, while the Parks Department's Notice to Cure concurred with some of the principal determinations of the Draft Audit (e.g., "Benefits Received from Sponsors", "Sponsorship Benefits for Goods and Services"), it did not concur with other principal determinations in the Draft Audit (e.g., "Deductions from Broadcast Revenues", "Late Charges").

This document prepared by the USTA, and dated and submitted on June 27, 2005, contains the USTA's principal corrections of and concurring responses to the Draft Audit.

**A. Most Significant Finding: USTA Complies with Lease and Maintains Adequate Financial Controls.**

Over a period of almost 24 months, from July 2003 to June 2005, in conducting the Draft Audit, the Comptroller's experienced professional audit staff spent what appears to have been hundreds, and perhaps thousands of hours investigating the USTA's tennis and administrative operations and interviewing its operating and financial staff; reviewing immense quantities of financial records, sponsorship agreements, contracts for goods and services, ledgers, computer records, rent receipts, invoices, Parks Department files, insurance certificates, correspondence files, computerized advanced ticket payment reports, sublicensee annual sales reports and daily cash register reports, among other documents; reviewing and testing financial reporting systems and procedures including, among others, internal controls for revenue recording and reporting, Ticketmaster's computerized ticket sales system, reporting systems and procedures for all daily box office transactions; and undertaking a wide variety of independent valuation studies and procedures to determine the market value or cost of numerous goods and services including, for example, hats, bottled drinks, refrigeration units, auto transportation services, print advertising, scoreboards and LED information screens, among others. After nearly two years of investigation

<sup>1</sup> The United States Tennis Association Incorporated, a 501(c)(6) tax exempt organization ("USTA"), is the sole member of the USTA National Tennis Center Incorporated, a 501(c)(3) tax exempt organization ("USTA NTC"). In 1993, the USTA NTC entered into a 99-year lease with the City of New York to construct, renovate, maintain and operate the USTA National Tennis Center in Flushing Meadows-Corona Park.

and extensive, wide-ranging and tenacious auditing activities, the central conclusion of the Draft Audit which appears on its very first page is this:

**“The USTA generally adhered to the provisions of their lease agreement with the City and had adequate controls over their revenue collection and reporting functions.”**

In other words, although stated in the sparse language of audit reports, the Draft Audit provides essentially a clean bill of health from New York City's highest Charter-established independent financial and auditing office, confirming that the USTA has established financial reporting and control procedures and systems for the NTC and its activities which are transparent, accurate and comport with best practices of financial accounting.

For the USTA and hopefully for the taxpayers and citizens of New York City, the Draft Audit's conclusion is both reassuring and a matter of some pride.

As one would expect in any audit of this scope, the Draft Audit goes on to discuss some circumstances and transactions, which are by no means widespread or numerous, where it differs with the methods or results of USTA accounting, business or reporting decisions. Such differences are neither unusual nor unexpected given the time and effort the Comptroller's Office devoted to the Draft Audit, particularly against the backdrop of the USTA's operations, revenues and financial procedures, the nature of which are extremely broad and complex. However, in every such instance noted in the Draft Audit, the issues involved are essentially ones of Lease interpretation and accounting judgments about which reasonable professionals with expertise in these areas can and do differ. It therefore is not surprising that the USTA, after conducting a detailed and thorough review of the Draft Audit, both firmly differs with a number of the Draft Audit's most significant findings, and, at the same time, concurs willingly in part or in whole with many of the Draft Audit's significant findings. The specific areas of agreement and disagreement are covered in detail in Part III below.

**B. The Importance of the NTC to New York City.**

Any audit by the Comptroller's Office of the USTA NTC's compliance with the Lease should be considered and understood in a broader context, one that places the relatively narrow and limited number of financial, accounting and Lease interpretation issues covered by the Draft Audit in the wider perspective of the overall costs and benefits to the City of New York of having the NTC located in the Borough of Queens in one of the City's most important and most celebrated public parks, Flushing Meadows-Corona Park.

Ordinarily, an official audit or a response to an official audit would contain a standard cost-benefit analysis of the underlying publicly owned, privately operated world class sports facility and would describe certain routine economic impact, employment creation and tax generation analyses and their results. Much of the information and data concerning the impact of the NTC has already been made public, including the findings of a study jointly announced by the Comptroller's Office and the USTA in 2001. Instead of repeating or summarizing that information here, it seems more fitting and appropriate to quote words used by the USTA's Executive Director and Chief Operating Officer, Lee Hamilton, in his letter of this date transmitting this response of the USTA to Deputy Comptroller Greg Brooks. His comments vividly convey not only the benefits of the NTC but also the spirit of the USTA's commitment to New York City and its dedication to operate and maintain facilities and programs at the NTC that generate the highest possible return – financial and otherwise – to the City and to the public. Mr. Hamilton's letter, referring to the completion of the NTC in August 1978, states in part:

"At that time, the USTA and the City of New York embarked on an extraordinary, long term journey that has defied the well known trends of tax breaks, concessions and the use of municipalities as bargaining chips to select the city a sports entity calls 'home'. Nearly three decades removed from its opening, the NTC remains one of, if not 'the', greatest and most unique venues in the country. In addition to hosting the US Open (the world's largest annually attended sporting event), the NTC serves as the world's largest public tennis facility, open to the public 11 months of the year. The NTC also represents a rare example of a world class sports venue that currently pays approximately \$2 million in municipal rent each year despite the fact that it was constructed without the use of any taxpayer money – a win-win for the USTA and the people of New York City.

Over the years, the USTA has invested hundreds of millions of dollars in the NTC. Our biggest investment to date made its debut in 1997 with the opening of Arthur Ashe Stadium – the crown jewel of the NTC and a court that has played host to some of the greatest tennis matches of all time, each seen in person by 20,000+ spectators and viewed by worldwide television audiences that have exceeded tens of millions of people. Since 1994, the USTA has spent more than \$344 million renovating and improving the NTC – including the construction of Arthur Ashe Stadium. No City money has been required or requested. Our approach to stadium construction was so unique that Mayor Bloomberg acknowledged in 2002 that it was 'the only good athletic sports stadium deal, not just in New York, but in the country.'"

**II. PRINCIPAL DIFFERENCE BETWEEN USTA AND DRAFT AUDIT: \$228,414 ADDITIONAL RENT AND FEES FOR NINE (9) YEARS (AVERAGE OF \$25,380 PER YEAR).**

One clear measure of the success and benefits of the Lease to both the City and the USTA is the growth in rental fees paid by the USTA to the Parks Department. In the 11 full calendar years since the Lease was signed, US Open revenues have grown by 500% and base rent and percentage rent paid to the Parks Department have grown from \$320,000 in 1994 to \$2,020,000 in 2004, a 630% increase. In that same 11 year period, total rent paid was approximately \$13,560,000. Clearly, the Lease was a good deal for all parties.

Against this background of swelling revenues and rent payments, the Comptroller's Draft Audit appropriately asks – given the sweeping, yet at times ambiguous, definition of Gross Revenues in Section 3.03(d) of the Lease – whether a perhaps more liberal interpretation this Section might yield even more Gross Revenues from which additional percentage rental payments could be mined. Not altogether surprisingly, the Draft Audit concludes that over the nine (9) year period of 1996-2004, the USTA should have reported \$31+ million in additional Gross Revenues and should therefore pay an additional \$333,949 in rent and late fees.

Concurring with some of the Draft Audit's conclusions and differing with others based on its interpretation of the Lease and GAAP accounting standards, the USTA has concluded from its detailed review of the Draft Audit that it should report only \$10+ million in additional Gross Revenues and pay \$105,535 in additional rent for the 1996-2004 period.

**In other words the Draft Audit and the USTA differ as to \$228,414 in additional percentage rent and fees, an average of \$25,380 for each of the nine (9) years examined between 1996-2004 (based on their difference as to \$20+ million in additional Gross Revenues for that period).**

More specifically, the Draft Audit's Table 1 summarizes the calculations and analysis on which its additional Gross Revenue and rent conclusions are based, as set forth on the following page. The USTA's analysis of the Draft Audit and corrections of the Draft Audit's Table 1 summary findings also appear on the following page.

**Table I**  
**Schedule of Underreported Revenue, Additional Rent and Late Charges Due**

Underreported Revenue Category	Underreported Revenue				
	Calendar Year 2002	Calendar Year 1996-2001	Calendar Year 2003-2004	Total Underreported Revenue	Additional Rent Due The City
Broadcasting Revenue Offsets	\$ 1,410,139	\$ 7,140,156	\$ 2,954,651	\$ 11,504,946	\$ 115,049
Sponsorship Revenue	1,845,300			1,845,300	18,453
Additional Sponsorship Revenue	1,275,000	5,480,157	2,550,000	9,305,157	93,052
Hospitality Revenue	307,268			307,268	3,073*
Additional Sponsorship Benefits	2,220,918			2,220,918	22,209
Food Concession Additional Revenue		3,000,000		3,000,000	30,000*
Revenue Adjustments		3,002,389		3,002,389	30,024*
<b>TOTAL</b>	<b>\$ 7,058,625</b>	<b>\$ 18,622,702</b>	<b>\$ 5,504,651</b>	<b>\$ 31,185,978</b>	<b>\$ 311,860</b>
Additional Percentage Rent Due the City					\$ 311,860
Additional Late Charge					22,089
<b>Total Amount Due</b>					<b>\$ 333,949</b>

The USTA's analysis of the Draft Audit and correction of the Draft Audit's Table 1 summary findings are as follows:

Recalculation of Revenue, Additional Rent and Late Charges

Corrected Revenue Category	Corrected Revenues				Correct Additional Rent
	Calendar Year 2002	Calendar Year 1996-2001	Calendar Year 2003 - 2004	Total Corrected Revenues	
Broadcasting Revenues Offsets	-	-	-	-	-
Sponsorship Revenues	-	-	-	-	-
Additional Sponsorship Revenues	465,105	1,952,221	1,032,488	3,449,814	34,498
Hospitality Revenues	307,268	-	-	307,268	3,073*
Additional Sponsorship Benefits	793,966	-	-	793,966	7,940
Food Concession Additional Revenue	-	3,000,000	-	3,000,000	30,000*
Revenue Adjustments	-	3,002,389	-	3,002,389	30,024*
<b>TOTAL</b>	<b>1,566,339</b>	<b>7,954,610</b>	<b>1,032,488</b>	<b>10,553,437</b>	<b>105,535</b>
Additional Percentage Rent Due to City					105,535
Additional Late Charge					-
<b>Total Amount Due</b>					<b>105,535</b>
Amounts Paid*					63,097
<b>Total Balance Due</b>					<b>42,438</b>

\*USTA remitted a check totaling \$63,097 to the City for the additional rent due to underreported hospitality revenue, unreported food concession revenue, and prior-period revenue adjustments, subsequent to the issuance of the preliminary draft report.

An average annual sum of \$25,380, which constitutes just slightly more than 1% of USTA annual rental payments that now exceed \$2 million, may seem to some a relatively minor matter (even more so in the context of the City's annual multi-billion dollar budget). But this is not so for either the City of New York or the USTA. The premise at the very core of the Lease is that the USTA should pay the City every penny it is due and the City should be able to assure its citizens and taxpayers that it is collecting every penny it is owed by the USTA. Compliance with the Lease is paramount to both parties and is the foundation of their successful partnership and the success of the NTC.

Before turning below to Part III's detailed analysis of those areas in the Draft Audit as to which the USTA and Comptroller agree and disagree, a brief response is in order regarding recommendation "3" at page 12 of the Draft Audit. Recommendation 3 suggests that the Parks Department and the USTA "should establish guidelines" concerning complimentary tickets. This subject is not covered in the Lease and as a result, in the course of the audit process both the USTA and the Comptroller's representatives concluded that there could be a need for greater clarity as to which categories of such tickets, if any, might have an imputed value that should be included in Gross Revenues. As a result, the USTA and Parks Department have already agreed to discuss this matter further and to seek guidance from the City's Corporation Counsel.

**III. DRAFT AUDIT'S ERRORS AND DEFICIENCIES; USTA'S CONCURRING RESPONSES.**

Draft Audit Findings	\$31,185,978	-	Total Additional Gross Revenues
	\$ 311,860	-	Total Additional Rent Due
Correct Findings	\$10,553,437	-	Correct Total Additional Gross Revenues
USTA: (Lease/GAAP Based Analysis)	\$ 105,535	-	Correct Total Rent Due

The charts in Part II above summarize the USTA's corrections to, recalculations of and concurring responses with respect to the specific findings and Gross Revenues and additional rent determinations set forth in pages 7-12 of the Draft Audit ("Findings and Recommendations"). The USTA's detailed analysis of each of the areas summarized in those charts is set forth in the sections lettered A-H which follow.

The specific USTA responses fall into three (3) discrete categories:

- A total of three (3) Draft Audit findings are clearly erroneous due to misinterpretation of or a failure to consider specific applicable Lease provisions and/or a failure to comport with or apply GAAP accounting standards which are mandated by the Lease respecting determinations of USTA Gross Revenues and Excluded Revenues (revenues not to be included in Gross Revenues) related to the US Open and other "Tennis Events". See "A", "B" and "H" below.
- A total of two (2) Draft Audit findings involve substantial deficiencies in critical valuation calculations respecting certain goods, services or payments provided to the USTA under various sponsorship agreements. See "C" and "E" below.
- There are a total of three (3) Draft Audit findings with which the USTA concurs and accordingly it has made appropriate additional rental payments prior to the issuance of the Draft Audit or any final Audit. See "D", "F" and "G" below.

The USTA's evaluation of errors and deficiencies in the Comptroller's findings, as well as the analysis of those matters as to which the USTA concurs with the Comptroller, were guided by two fundamental measures, to wit: **each USTA response in the numbered paragraphs below was based on: (1) the advice and interpretations of the USTA's general counsel and special outside counsel, as well as consultation with the City's Corporation Counsel and Parks Department counsel, as to the definition of "Gross Revenues" in Lease Section 3.03(d)(ii) and related provisions of the Lease; and (2) the USTA's independent outside auditor's review and acceptance of the USTA's accounting treatment and reporting in the USTA's GAAP-based audited financial statements for the appropriate time periods in question, which include the transactions and payments addressed by the Draft Audit.**

In this regard, it should be noted that while Section 3.03(d)(ii) of the Lease requires the USTA to strictly adhere to GAAP standards in its financial records and reporting as well as in its



calculation of Gross Revenues and annual rental payments, the Draft Audit makes no mention of and does not appear to apply GAAP standards in its evaluation of USTA financial transactions and Gross Revenues calculations and reporting.

**A. Pass-Through Host Broadcaster Service Fees Properly Excluded from Gross Revenues per Lease Sections 3.03(d)(iii)(8) and 28.01(b). No Unreported Gross Revenues.**

Draft Audit Finding (p. 7)	\$11,504,946	–	Additional Gross Revenues
	\$ 115,049	–	Additional Rent Due
Correct Finding USTA: (Lease/GAAP Based Analysis)	\$ 0	–	NO Additional Gross Revenues
	\$ 0	–	NO Additional Rent Due

1. Comptroller's Position: The Draft Audit at page 7 erroneously states that the USTA improperly deducted certain broadcaster payments from Gross Revenues. The Comptroller's audit determination is incorrect under Lease Section 3.03(d)(iii)(8) and is inconsistent with the GAAP financial reporting requirements imposed on the USTA under the Lease agreement with the City of New York.
2. Correct Analysis: The USTA has extensively explained to the Comptroller's Office the pass-through Host Broadcaster fee transaction. Nevertheless the Draft Audit incorrectly concludes that the USTA underreported \$11,504,946 in Gross Revenues over a period of nine years. The Host Broadcaster pass-through fee transactions involve payments by twenty-two (22) international TV sports broadcasters to the Host Broadcaster for services and expenses incurred by the Host Broadcaster in order to provide live TV transmission "feeds" of U.S. Open Tennis Events. For reasons of convenience and efficiency, the USTA collects these fees and then credits or pays the amount collected to the Host Broadcaster.

The finding of the Comptroller's Office identifies payments received by the USTA for the account of the domestic Host Broadcaster as Gross Revenues despite the following facts:

- a. Such payments are collected for the benefit of and credited to the Host Broadcaster, not the USTA.
- b. The USTA receives cash on behalf of Host Broadcaster and pays it over to the Host Broadcaster. Therefore, the USTA receives zero revenue and keeps zero cash. The USTA is merely a conduit between the Host Broadcaster and the international broadcasters. Including such amounts in Gross Revenues would effectively overstate revenues.
- c. Lease section 3.03(d)(iii)(8) specifically recognizes this type of "pass-through" payment transaction as Excluded Revenue which is not included in Gross Revenues.
- d. Accordingly, the payments received on behalf of the Host Broadcaster should not be and are not recognized as revenue or Gross Revenue in the USTA's Lease mandated GAAP financial reporting and certified audited financial statements.

The Draft Audit's determination does not comport with the accounting principles applicable under the Lease. The Draft Audit's determination, if followed, would incorrectly overstate Gross Revenues.

**B. Contrary to the Draft Audit, \$1,845,200 of Sponsorship Fees, Expenses and Payments Were Properly Accounted for on a GAAP Basis. No Unreported Gross Revenues.**

Draft Audit Finding (p. 8)	\$1,845,300	–	Additional Gross Revenues
	\$ 18,453	–	Additional Rent Due
Correct Finding USTA: (Lease/GAAP Based Analysis)	\$ 0	–	NO Additional Gross Revenues
	\$ 0	–	NO Additional Rent Due

1. Comptroller's Position: The Draft Audit at page 8 incorrectly states that Sponsorship Revenue was underreported by \$1,845,300 and that the USTA owes the City \$18,453 as percentage rent (plus a late charge).

The Draft Audit states that:

- a. the USTA allocated \$695,200 of sponsorship revenue to a "non-US Open program" and should not have excluded it from revenue.
- b. the USTA inappropriately deducted \$925,100 of "Sponsorship Expenses" from sponsorship revenue.
- c. the USTA did not include a \$225,000 sponsorship payment in 2002 and 2003 for the 2003 US Open to be broadcast at Rockefeller Center.

The Comptroller does not cite any relevant Lease provisions to support its findings.

2. Correct Analysis: No additional amount should be added to Gross Revenues; no percentage rent or late charge is due.
  - a. \$695,200 of Sponsorship Revenue allocated to USA League Tennis. The definition of "Excluded Revenues" in Lease Section 3.03(d)(iii)(3) allows for the exclusion of "sponsorship or advertising revenue other than as described in clause [3.03(d)(ii)](3) from Gross Revenues." Clause "(3)" refers to "revenues from sponsorships of Tennis Events and other advertising revenues **generated from the Project Site** and in connection with Tennis Events".

Pursuant to Lease Section 3.03(d)(iii)(3), the USTA allocated to USA League Tennis a fair value of fees received from two sponsors. Both of the underlying sponsorship agreements specifically state that the respective companies are "the" sponsors for the USA League Tennis nationwide tennis program, which has approximately 600,000 participants, operates on a year-round basis throughout the country, and is unrelated to the Project Site (the NTC). The value allocated to USA League Tennis was conservatively derived from industry standards. In this regard, the USTA has provided the Comptroller with additional documentation that demonstrate that the \$695,200 allocated to USA League Tennis is

significantly less than the fair market value of similar sponsorships. In other words, its cost in the marketplace would greatly exceed the conservative valuation used by the USTA.

The Draft Audit finding ignores both the explicit Lease provision that permits the USTA to allocate sponsorship fees to non-Project Site programs, as well as the marketplace information supplied by the USTA. The Comptroller's determination that the USA League Tennis sponsorship has no value is invalid. The \$695,200 should not be included in Gross Revenues used to calculate rent payable to the City of New York.

- b. Sponsorship Expenses of \$925,100. This amount was offset against sponsorship revenues because the USTA expended \$925,100 on items that it purchased on behalf of various sponsors. For example, the USTA purchases and installs signage throughout the NTC on behalf of its US Open sponsors. This service is one that the USTA is obligated to provide to such sponsors and the expenses associated with the service are paid for by a portion of the sponsorship fees. The USTA deducted the expenses incurred from the sponsorship revenues to correctly reflect the actual revenue received by the USTA. This amount was appropriately excluded from Gross Revenues.
- c. Sponsorship Payment of \$225,000. This sponsorship payment was for a community event held at Rockefeller Center in 2003, whereby the USTA provided the general public with a free broadcast of the US Open as part of its mission to grow and promote the sport of tennis.

As set forth in Section 3.03(d)(ii) of the Lease, Gross Revenues includes "gross rents, receipts, fees...accruals during the Lease Year...by or for the account of (x) Tenant, (y) USTA or any successor to the USTA that holds Tennis Events at the **Project Site**...from, in connection with, or directly or indirectly arising from activities existing from the **Project Site** and from the operation of the Premises...".

Revenue from this event at Rockefeller Center was appropriately excluded on a GAAP basis from Gross Revenues under the Lease because it was not from "the **Project Site** and from the operation of the Premises". Furthermore, the sponsorship payment to the USTA goes to fund the cost of staging the free public event.

**C. The Draft Audit Substantially Overstates the Value of Sponsor Benefits to be Included in Gross Revenues. Correct Amount to be Included in Gross Revenues: \$3,449,814.**

Draft Audit Finding (p. 8)	\$9,305,157	–	Additional Gross Revenues
	\$ 93,052	–	Additional Rent Due
Correct Finding USTA (Lease/GAAP Based Analysis)	\$3,449,814	–	Correct Additional Gross Revenues
	\$ 34,498	–	Correct Additional Rent Due

1. Comptroller's Position: The Draft Audit at page 8 incorrectly concludes that the USTA received \$9,305,157 of value in sponsor benefits for services provided from 1997 through 2004, and that \$93,052 is due as additional rent. Based on the USTA's extensive sports-related technical expertise and procurement experience involving world class tennis events, it has calculated the value of the sponsor provided services in question to be \$3,449,814, approximately one-third of the Draft Audit's non-expert valuation.
2. Correct Analysis: The Draft Audit has incorrectly applied a "not to exceed amount" clause in a 2003 sponsorship contract to determine the value of non-monetary services that it claims the USTA should have included in Gross Revenues. The "not to exceed amount" represents the maximum possible value for services that the sponsor was willing to provide.

Based on a substantially overstated "not to exceed" valuation of the 2003 sponsorship contract services (\$1,275,000), the Draft Audit compounds the valuation error by attributing substantially the same value to sponsorship services in each of the eight (8) years from 1997 to and including 2004. The USTA, based on its industry knowledge and expertise, has estimated the value of the benefit received to be slightly above one-third (33%) of the amount included in the Draft Audit. Not only was it incorrect to apply a "not to exceed amount" as the monetary value for the services, it was also incorrect to assume that the services provided in 2003 were substantially the same in each of the additional eight years included in the Draft Audit. Services received by USTA from sponsors have changed dramatically over the years, particularly since 1997. Accordingly, the USTA disagrees with the "imputed" amount claimed by the Comptroller's office and has advised the Comptroller that the appropriate amount of \$3,449,814 should be included in Gross Revenues for the eight (8) year period.

3. USTA Recalculation. As a result of the audit review process with the Comptroller's Office, the USTA has concluded that it is appropriate to include in Gross Revenues reported under the Lease the correctly calculated estimated value of the sponsor-provided services in question. In other words, the USTA concurs with the Draft Audit's basic conclusion in this area. The USTA does not, however, concur with the Draft Audit's erroneous valuation of these services.

**D. Concurring Response: Hospitality Renewals Appropriately Included in Gross Revenues. \$307,268 Additional Gross Revenues.**

Draft Audit Finding (p. 9)	\$307,268	-	Additional Gross Revenues
	\$ 3,073	-	Additional Rent Due
Concurring Finding USTA: (Lease/GAAP Based Analysis)	\$307,268	-	Additional Gross Revenues
	\$ 3,073	-	Additional Rent Paid

1. Comptroller's Position: The USTA concurs with the Draft Audit's inclusion in Gross Revenues, at page 9, of the \$307,268 in hospitality renewals and has accordingly paid \$3,073 as additional rent to the City of New York prior to the issuance of the Draft Audit.

**E. Draft Audit's Calculation of Sponsorship Benefits' Fair Market Value Is More Than Twice Actual Value.**

Draft Audit Finding (p. 9)	\$2,220,918	–	Additional Gross Revenues
	\$ 22,209	–	Additional Rent Due
Correct Finding USTA	\$ 793,966	–	Correct Additional Gross Revenues
(Lease/GAAP Based Analysis)	\$ 7,940	–	Correct Additional Rent Due

1. Comptroller's Position: The Draft Audit at page 9 concludes that the fair market value of certain goods and services received in 2002 from sponsors was \$2,220,918. The correct value of these good and services, if any, was \$793,966.
2. Correct Analysis: The Draft Audit has incorrectly applied an inflated market value formula to determine the "benefits" of certain goods and services received from USTA sponsors. Many of the perceived "benefits" are clearly benefits and requirements of the involved sponsors (as reflected in their sponsorship fees) rather than benefits sought or required by the USTA. For example, refrigeration units provided by sponsors are typically a requirement of the vendor to sell their product. From the USTA's point of view the value of these items, if any, is de minimis and accordingly they are not accounted for in the USTA's annual financials; a determination agreed to by the USTA's independent auditors.

Notwithstanding the de minimis value of these types of items from a GAAP Accounting perspective, the USTA has agreed to allocate a Gross Revenue value to these "benefits" based on the estimated cost to procure such items rather than the inflated list prices used in the Draft Audit. By way of example, the Draft Audit overstated the value of hats provided by a US Open sponsor at \$17.99 per item (a retail value based on a public website), compared to the USTA's estimate of \$4.25 per item based on an invoice for hats the USTA actually purchased for other purposes. Other examples in the Draft Audit use similar "list price" valuation methods. In fact, a substantial number of the items in question, regardless of their value, would never be procured or used by the USTA. Their use by sponsors, which primarily serves the particular sponsor's marketing or other business objectives, typically represent a courtesy extended by the USTA, as opposed to a USTA request or requirement.

While the specific items covered in the Draft Audit – hats, soft drinks, refrigerators, etc. – are mostly de minimis as a matter of financial accounting, it is not necessarily inappropriate to include the procurement-value of some of these items in Gross Revenues as the Draft Audit concludes. Clearly, some of the industry business practices and sponsorship transactions covered by the Draft Audit are ones that give rise to valuations about which reasonable financial and auditing professionals may differ. In this regard, the USTA is mindful that throughout the audit process the Comptroller's representatives have concurred with various positions of the USTA, after initially concluding otherwise. In this instance it seems appropriate for the USTA to do likewise.



The USTA believes the value of these perceived benefits is de minimis, however, because the Comptroller's office has taken the position that a value should be attributed to these items, the USTA concurs, but believes the correct value to be included Gross Revenues is \$793,966, and the additional rent due is \$7,940.

**F. Concurring Response: 1998 Payment By Food Service Sublicensee Constitutes Gross Revenue. \$3,000,000 Additional Gross Revenue.**

Draft Audit Finding (p. 10)	\$ 3,000,000	–	Additional Gross Revenues
	\$ 30,000	–	Additional Rent Due
Concurring Finding USTA: (Lease/GAAP Based Analysis)	\$ 3,000,000	–	Additional Gross Revenues
	\$30,000	–	Additional Rent Paid

1. Comptroller's Position: The USTA concurs with the Draft Audit's inclusion in Gross Revenues, at page 10, of the \$3,000,000 payment made in 1998 by a food sublicensee and has accordingly paid \$30,000 as additional rent to the City of New York prior to the issuance of the Draft Audit.

**F. Concurring Response: 1998 Payment By Food Service Sublicensee Constitutes Gross Revenue. \$3,000,000 Additional Gross Revenue.**

Draft Audit Finding (p. 10)	\$ 3,000,000	-	Additional Gross Revenues
	\$ 30,000	-	Additional Rent Due
Concurring Finding USTA: (Lease/GAAP Based Analysis)	\$ 3,000,000	-	Additional Gross Revenues
	\$30,000	-	Additional Rent Paid

1. Comptroller's Position: The USTA concurs with the Draft Audit's inclusion in Gross Revenues, at page 10, of the \$3,000,000 payment made in 1998 by a food sublicensee and has accordingly paid \$30,000 as additional rent to the City of New York prior to the issuance of the Draft Audit.

**H. No Late Charges Due When Recalculated Additional Gross Revenues Are Less Than 5% of Total Gross Revenues. No Late Charges Due.**

Draft Audit Finding (p. 11)	\$7,058,625	–	Additional Gross Revenues
	\$ 22,089	–	Late Charges Due
Correct Finding USTA: (Lease/GAAP Based Analysis)	\$1,566,339	–	Correct Additional Gross Revenues / Below 5%
	\$ 0	–	NO Late Charges Due

1. Comptroller's Position: The Draft Audit at page 11 erroneously determines that a late charge of \$22,089 is due based on an incorrect calculation of unreported additional Gross Revenues as exceeding 5% of the total Gross Revenues for 2002.
2. Correct Analysis: According to Section 3.03(c) of the Lease, the USTA must pay the City late charges as follows: "if any installment of percentage rent has been underpaid by Tenant, Tenant shall pay the amount of such underpayment, plus interest thereon at the late charge rate in the event such underpayment exceeds five percent (5%) for the period from the date such payment should have been made to the date such payment shall be made, within ten (10) days after demand."

As noted previously in this response (see charts in Part II above), the Draft Audit erroneously calculated additional Gross Revenues of \$7,058,625 for 2002. The correct amount is \$1,566,339, well below the 5% threshold required for imposition of late charges pursuant to Section 3.03(c) of the Lease.

However, even accepting the Draft Audit's Gross Revenues determinations, the claimed late charges are miscalculated. The Draft Audit incorrectly calculated late charges from the date of January 30, 2002. Pursuant to Section 4.01 of the Lease, rent payments are not deemed "late" until thirty (30) days after the end of 2002 (i.e. – January 30, 2003). As such, the Draft Audit's calculation should at a minimum be reduced by \$6,706 to \$15,383.



City of New York  
Parks & Recreation

Adrian Benepe  
Commissioner

The Arsenal  
Central Park  
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Assistant Commissioner  
Revenue

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June 23, 2005

**BY FAX AND MAIL**

Mr. Greg Brooks  
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 the USTA National Tennis Center, Inc.  
January 1, 2002 through December 31, 2002 (Also, for certain areas extended to  
1996 through 2001, and 2003 through 2004) Audit No. FM04-074A**

Dear Mr. Brooks:

This letter represents the Parks Department's ("Parks") response to the recommendations contained in the subject audit of the USTA National Tennis Center, Inc. ("USTA").

Parks has issued the attached "Notice To Cure" ("NTC") to the USTA requesting payment under **Recommendation 1** for the partial amount of \$131,464 covering the following audit categories:

Underreported Sponsorship Revenue	\$ 16,203
Additional Unreported Benefits Received from a Sponsor	93,052
Additional Unreported Sponsorship Benefits for Goods and Services	<u>22,209</u>
<b>TOTAL AMOUNT BILLED</b>	<b><u>\$131,464</u></b>

The remaining principal balance of \$117,299 is being referred to the City's Law Department for resolution. The items requiring legal review are:

Improper Deductions from Broadcast Revenue	\$115,049
Sponsorship Payment for broadcast of the US Open at Rockefeller Center	<u>2,250</u>
<b>AMOUNT TO BE REFERRED TO CITY'S LAW DEPARTMENT</b>	<b><u>\$117,299</u></b>

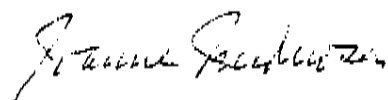
Greg Brooks  
June 23, 2005  
Page 2

In reviewing Appendix I of the audit report covering the "Late Charge" component, \$22,089, of Recommendation 1, we calculated that the stated "Amount Underpaid" was less than five percent (5%) of the "Adjusted Revenue." The lease requires that an underpayment must exceed 5% for a late charge to apply. Therefore, Parks did not bill the USTA the \$22,089.

To comply with **Recommendation 2**, the NTC required that the USTA implement the necessary accounting procedures to ensure that all revenue including the value of all benefits received from its sponsors is reported to the City. **Recommendation 3** suggests that the USTA in conjunction with Parks should establish guidelines for issuing and reporting complimentary tickets. Although the lease does not provide any restrictions for issuing and reporting complimentary tickets to the City, Parks appreciates the Comptroller's concern and comments on this subject. Parks will consult with and seek the advice and guidance of its legal counsel and the City's Law Department in this matter and if feasible, will coordinate with the USTA to implement a guideline for complimentary tickets.

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

Sincerely,



Joanne Imohiosen

cc: Comm. Adrian Benepe  
Francisco Carlos  
Alessandro Olivieri  
David Stark  
Susan Kupferman, Mayor's Office of Operations



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June 23, 2005

**BY FAX AND MAIL**

Ms. Sonja Espinal  
Chief Financial Officer  
Director of Administration  
United States Tennis Association  
70 West Red Oak Lane  
White Plains, NY 10604

Re: **NOTICE TO CURE**

**Comptroller's Draft Audit Report on the USTA National Tennis Center, Inc.  
January 1, 2002 through December 31, 2002 (Also, for certain areas extended to  
1996 through 2001, and 2003 through 2004) Audit No. FM04-074A**

Dear Ms. Espinal:

This letter addresses the findings and recommendations contained in the subject audit of the USTA National Tennis Center, Inc. ("USTA"). In general, the report stated that the USTA has adhered to the provisions of its lease agreement with the City and had an adequate system of internal controls over their revenue collection and reporting functions. Furthermore, the report indicated that the USTA had paid the appropriate amount towards road and park improvements, maintained the required property and liability insurance, paid its water and sewer charges, and paid its rent on time. However, for the period examined the audit disclosed that the USTA underreported its revenue to the City by \$31,185,978. Consequently, the report concluded that the USTA owes the City \$333,949 in additional percentage rent and late charges.

Specifically, the report recommends that the USTA:

**Recommendation 1.** Pay the City the remaining \$270,852 due (\$248,763 in additional percentage rent and \$22,089 in late charges).

Sonja Espinal  
June 23, 2005  
Page 2

From the total Comptroller's assessment of \$333,349 the USTA has agreed to pay \$63,097 representing the following revenue categories and has remitted a check for that amount to the Parks Department ("Parks"):

<u>Underreported Revenue Category</u>	<u>Additional Rent Due</u>
Hospitality Revenue	\$ 3,073
Food Concession Additional Revenue	30,000
Revenue Adjustments	<u>30,024</u>
<b>Total Amount Agreed to and Paid by USTA</b>	<b><u>\$63,097</u></b>

The remaining items that follow cover issues where the USTA disagreed with the audit report:

**Improper Deductions from Broadcast Revenue**

The report states that the USTA improperly deducted \$11,504,946 in "Host Broadcaster Service Fees" ("HBSF) from Broadcast revenue for the calendar years 1996 through 2004. Consequently, the auditors calculated that the USTA owes the City \$115,049 in additional percentage rent in connection with the improper deductions taken in those years.

The audit report notes that according to the lease, the USTA is required to "include, without limitation . . . revenues from direct, live, or taped broadcasting, in the United States and internationally of Tennis Events, whether by network, cable, tape delayed broadcast, pay per view or other device or system for contemporaneous viewing of Tennis Events." Therefore, the report concluded that there is no contract provision that allows for the deduction of "HBSF." At the Audit Exit Conference the USTA explained that the deducted HBSF simply represented a "pass-through" of International Host Service Fees ("IHSF") to the proper recipient. The USTA derived no income from the IHSF but was merely collecting the fees as an accommodation to the local Broadcast Company that ultimately received the money.

Parks understands the USTA's position on this item and its rationale for deducting the "pass-through" HBSF from broadcasting revenue. The net effect of the HBSF transactions which increases revenue from the International Hosts and reduces income from the local broadcast company is zero. However, because the lease does not specifically allow the HBSF credits Parks will refer this matter to the City's Law Department for a legal opinion. After Parks confers with its legal counsel a determination on the \$115,049 additional percentage rent assessment will be rendered.



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### Underreported Sponsorship Revenue

The auditors found that the USTA underreported its 2002 revenue by \$1,845,300 and consequently owes the City \$18,453 in additional percentage rent. A breakdown of the underreported total follows:

- The USTA allocated \$695,200 of sponsorship revenue to a “non-US Open program” and excluded it from the amounts reported to the City. However, the audit report states that the USTA was unable to provide sufficient information to validate the propriety of the transfer.
- The USTA deducted \$925,100 of sponsorship expenses from gross sponsorship revenue that is not allowable under the lease. The USTA indicated that the amounts credited against revenue represent expenses required under the sponsor’s contracts with the USTA and which were reflected in the sponsor’s fee payments to the USTA. However, as stated in the Comptroller’s report, the lease does not allow for this type of deduction.
- The USTA received and did not report to the City a \$225,000 sponsorship payment in 2002 for the 2003 US Open to be broadcast at Rockefeller Center. The report states that the lease requires the USTA to record revenue when received and pay the City the appropriate rent due. The USTA argued that Section 3.03(d)(ii) requires the USTA to only report revenues “. . . from, activities occurring at the Project Site and from the operation of the Premises . . .”

For the reasons noted above, Parks concurs with the first two audit findings of this section and requires that the USTA pay \$16,203. The third item covering the sponsorship payment for the “Off-Site” broadcast will be included with the other items to be forwarded to the City’s Law Department for legal review.

### Additional Unreported Benefits Received from a Sponsor

The audit disclosed that the USTA did not report \$9,305,157 in additional sponsorship benefits. Consequently, the USTA owes the City \$93,052 in additional rent. The lease requires that the USTA must include the monetary value of all goods and services it receives in calculating its gross revenues. The USTA argued that the value of the benefit to the USTA was substantially less than the audit valuation. The auditors indicated that their calculation was based on the actual information noted in the sponsor’s contract with the USTA. USTA officials mentioned that the benefit amounts recorded in the contracts represented inflated estimates and that the true value received was much less. However, since there is no way to accurately quantify this item, Parks agrees with

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the Comptroller's assessment that is derived from specific information provided by the sponsor.

Parks requires that the USTA pay the audit assessment in the amount of \$93,052 to resolve this item.

#### **Additional Unreported Sponsorship Benefits for Goods and Services**

The audit examination of the USTA's sponsorship agreements revealed that the USTA did not report \$2,220,918 for the estimated fair market value of goods and services it received in connection with its sponsorship agreements in calendar year 2002. Consequently, the auditors determined that the USTA owes the City \$22,209 in additional percentage rent. The USTA did not report the estimated fair market value of the following sponsorship benefits:

- \$1,981,766 in free advertisements from several newspaper and magazine companies.
- \$160,350 in goods from sport retailers and soft drink companies.
- \$78,802 in transportation, equipment and services.

At the Exit Conference USTA officials argued that the value of the goods and services received by the USTA was substantially less than the amounts calculated by the Comptroller's auditors. The USTA provided additional information to the audit team for review and consideration to re-evaluate the estimated worth assigned to the goods and services received. The auditors did reduce the total unreported amount stated in the "Preliminary Draft" report by nearly \$300,000, and the amount of the assessment by almost \$3,000. Again, as mentioned in the previous finding, Parks has no way of verifying the exact value of the goods and services provided to the USTA. However, the Comptroller's methodology for calculating the amount of the benefits provided did allow for a significant discount to the applied estimated values. Also, as mentioned above the underreported total and audit assessment were reduced based on the additional information submitted by the USTA.

Therefore, Parks agrees with the audit report on this item and requires that the USTA pay \$22,209 in additional rent.

#### **Late Charges Due**

The auditors calculated that the USTA owes the City \$22,089 in late charges for additional rent owed for underreporting revenues and road improvements. The underpaid

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amount on Appendix I however, is less than 5% of the total "Adjusted Revenue" as required by the lease for the late penalty to apply. Therefore, Parks is not assessing the USTA for the late charge and will note this in Parks' response to the Comptroller.

To summarize, the amounts paid, pending, cancelled and still owed, are as follows:

• Total amount remitted by the USTA	\$ 63,097
• Amount pending a legal opinion by the NYC Law Department	117,299
• Cancelled Late Fees	22,089
• Amount currently owed by the USTA as described above	<u>131,464</u>
<b>Total Amount Due Per Audit Report</b>	<b><u>\$333,949</u></b>

At this time, to comply with Recommendation 1 and this "Notice To Cure," the USTA should remit a check to this office for \$131,464 made payable to the City of New York Parks and Recreation. Any additional amount the USTA owes based on the City Law Department's opinion will be billed at a later date.

**Recommendation 2.** Report all National Tennis Center revenue, including the value of additional benefits received from sponsors and sublicensee revenues, to the City. These revenues should not be reduced by unallowable deductions.

The USTA should implement the necessary accounting procedures to ensure that all revenue including the value of all benefits received from its sponsors is reported to the City.

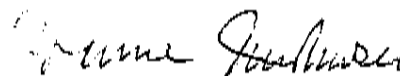
**Recommendation 3.** USTA in conjunction with Parks should establish guidelines for issuing and reporting complimentary tickets. The guidelines should establish categories of entities and individuals who may receive complimentary tickets for which the value does not have to be included in revenue reported to the City.

From their review the auditors believe that guidelines need to be established indicating the categories of entities and individuals who may receive complimentary tickets for which the value does not have to be included in revenue reported to the City. Parks will consult with its legal counsel and the City's Law Department to seek advice and guidance in this matter and if feasible, will coordinate with the USTA to implement a guideline for complimentary tickets.

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Finally, we want to take the opportunity to thank the USTA for their cooperation during the audit review and anticipate an expeditious resolution of the issues contained in the audit report.

Sincerely,



Joanne Imohiosen

cc: Comm. Adrian Benepe  
Francisco Carlos  
Gordon Davis (LeBoeuf, Lamb, Greene & MacRae LLP)  
Tandy O'Donoghue (USTA)  
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