



# City of New York

---

OFFICE OF THE COMPTROLLER

**John C. Liu**  
**COMPTROLLER**



## FINANCIAL AUDIT

**Tina Kim**

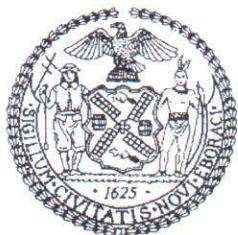
Deputy Comptroller for Audit

Audit Report on Carnegie Hall  
Corporation's Compliance with Its City  
Lease Agreement

FN12-068A

**November 15, 2012**

<http://comptroller.nyc.gov>



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

John C. Liu  
COMPTROLLER

November 15, 2012

**To the Residents of the City of New York:**

My office has audited the Carnegie Hall Corporation's (the Corporation) compliance with its City Lease Agreement. The Agreement requires the Corporation to pay the City 70 percent of the total rents (i.e., Base Rent and Gross Commercial Rents, less certain allowable expenses) it receives from its Subtenant, Carnegie Hall Tower II Limited Liability Company (CHTL).

The audit found that the Corporation did not report \$8,919,430 in Gross Commercial Rents of which Percentage Rent and interest totaling \$363,521 for Fiscal Year 2010 is due the City. Specifically, the Corporation allowed the Subtenant, CHTL, to deduct a total of \$8,695,344 in expenses from its Gross Commercial Rents in excess of the amount previously approved by the City and did not report rent receipts totaling \$224,086. We also found that the Corporation did not ensure the Subtenant submitted the quarterly Percentage Rent statements for True-Up Payments.

Further, our review found that DCAS did not adequately administer the lease to ensure that all the deductions from Gross Commercial Rents were properly reviewed and authorized by the City and that all revenue was properly collected and reported to the City in a timely manner.

The results of the audit have been discussed with the Corporation and DCAS officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my audit bureau at [audit@comptroller.nyc.gov](mailto:audit@comptroller.nyc.gov).

Sincerely,

A handwritten signature in black ink, appearing to read "John C. Liu".

John C. Liu

# TABLE OF CONTENTS

<b>AUDIT REPORT IN BRIEF</b> .....	<b>1</b>
Audit Findings and Conclusions .....	2
Audit Recommendations.....	2
Agency Response .....	3
<b>INTRODUCTION</b> .....	<b>4</b>
Background .....	4
Objectives.....	5
Scope and Methodology Statement.....	5
Discussion of Audit Results .....	5
<b>FINDINGS</b> .....	<b>7</b>
The Corporation Did Not Report Tower Property Gross Commercial Rents of \$8.9 Million .....	8
The Corporation Improperly Allowed \$8,695,344 in Gross Commercial Rent Deductions.....	8
The Corporation Did Not Ensure CHTL Reported Rental Revenue Totaling \$224,086 .....	9
The Corporation Did Not Require Submission of Quarterly True-Up Payments .....	10
Other Matters.....	11
DCAS Did Not Adequately Administer the Master Lease .....	11
DCAS Did Not Adequately Review Financial Records .....	11
DCAS Did Not Properly Calculate and Collect the Rents Payable to the City .....	12
<b>RECOMMENDATIONS</b> .....	<b>14</b>
<b>DETAILED SCOPE AND METHODOLOGY</b> .....	<b>16</b>
<b>ADDENDUM I</b> Carnegie Hall Corporation Response	
<b>ADDENDUM II</b> Carnegie Hall Tower II Limited Liability Company Response	
<b>ADDENDUM III</b> New York City Department of Citywide Administrative Services Response	

# THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER FINANCIAL AUDIT

## Audit Report on Carnegie Hall Corporation's Compliance with Its City Lease Agreement

**FN12-068A**

---

### AUDIT REPORT IN BRIEF

On June 30, 1960, the City and the Carnegie Hall Corporation (the Corporation) entered into a Master Lease agreement covering the Carnegie Hall building and the adjacent land located on Seventh Avenue at 57<sup>th</sup> Street in Manhattan. In 1987, the City allowed the Corporation to develop the Carnegie Hall Tower on the adjacent land (the Tower Property). Consequently, the City and the Corporation entered into a “restated” Master Lease, which covers the Carnegie Hall building and the Tower Property. The Corporation then subleased the Tower Property to Carnegie Hall Tower Limited Partnership—now known as Carnegie Hall Tower II Limited Liability Company (CHTL)—to manage and construct a 60-story office building with 548,904 square feet of commercial space.

Under the terms of the Sublease, CHTL must pay the Corporation a Base Rent equal to the greater of (a) full real estate taxes for the Carnegie Hall Tower or (b) \$3,010,350. CHTL is also required to pay the Corporation a Percentage Rent, which is 4 percent of Gross Commercial Rents less certain allowable Actual Expenses exclusions. In turn, the Corporation must pay the City 70 percent of the total rents (i.e., Base and Percentage Rents) received from CHTL. The Corporation is also required to submit an annual detailed written statement setting forth all Sublease Income during the preceding fiscal year together with a copy of any audited financial statements received from the Subtenant to the City. The New York City Department of Citywide Administrative Services (DCAS) is responsible for monitoring the Master Lease and ensuring that the Corporation complies with its contractual obligations with the City.

The Corporation must also pay the City a fixed annual rent of \$183,600 for the Carnegie Hall building. The City has, in lieu of rent payments, allowed the Corporation to make such payments available through its Special Program Fund (the Fund). The Fund is designated to provide special musical and cultural programs throughout the City and is monitored by the New York City Department of Cultural Affairs. Payments to the Fund are covered in a separate audit.

## Audit Findings and Conclusions

Our review found that the Corporation did not report \$8,919,430 in Gross Commercial Rents of which Percentage Rent and interest totaling \$363,521 for Fiscal Year 2010 is due the City. Specifically, the Corporation allowed the Subtenant, CHTL, to deduct a total of \$8,695,344 in expenses from its Gross Commercial Rents in excess of the amount previously approved by the City and did not report rent receipts totaling \$224,086. We also found that the Corporation did not ensure the Subtenant submitted the quarterly Percentage Rent statements for True-Up Payments.

Further, our review found that DCAS did not adequately administer the lease to ensure that all the deductions from Gross Commercial Rents were properly reviewed and authorized by the City and that all revenue was properly collected and reported to the City in a timely manner.

## Audit Recommendations

To address these issues, the audit recommends that the Corporation should:

- Pay the City additional 2009 Percentage Rent and interest of \$363,521 resulting from improperly deducted Actual Expenses and unreported Gross Commercial Rents.
- Ensure it submits all proposed Sublease modifications or clarifications to the City for its review and approval prior to implementation.
- Ensure CHTL accurately reports its Percentage Rent and submits detailed quarterly Percentage Rent statements.

To address these issues, the audit recommends that DCAS should:

- Ensure that the Corporation pays the Percentage Rent and interest of \$363,521 and implements all the other audit recommendations.
- Conduct a comprehensive review of claimed Actual Expenses for periods prior to our audit scope and quantify underpaid Percentage Rents and assess interest accordingly.
- Ensure that the Corporation submits all proposed Lease modifications or clarifications to the City for its review and approval prior to implementation and exercise due care and diligence to determine and document whether Lease modifications or clarifications are fair, equitable, and in the City's best interests.
- Periodically review the Corporation's financial submissions and conduct reviews or audits to ensure that the Corporation accurately reports revenues and pays the City all money due it.
- Properly bill the Corporation Base and Percentage Rents and collect any amounts due.

## Agency Response

While the Corporation disagreed that it should pay the City \$363,521, the Corporation did not offer a basis for its position. Moreover, the Corporation tacitly acknowledged that the City was short-changed by stating that it “will work with the New York City Department of Citywide Administrative Services (DCAS) to achieve a fair and equitable resolution of this matter.”

In its response, CHTL contends that the third Clarification Letter provided for certain extensions and expansions of Gross Commercial Rent exclusions and that “the City’s consent to this change was not required and, accordingly, these items have been excluded.” However, this letter was not expressly approved by the Corporation, i.e., it was never signed by the Corporation. More importantly, as noted, this letter was not submitted to or approved by the City. Article 34(a) of the Master Lease—which governs the Sublease—explicitly states that “Tenant may not alter or amend the Sublease without Landlord’s consent.” Because the proposed exclusions represented a material change in lease terms and rental payments due the City, the Corporation and CHTL should have formally sought and obtained the City’s approval. As noted, the Corporation and CHTL previously adhered to this requirement when modifying the Actual Expenses definition and reporting requirements in the first and second Clarification Letters, respectively.

DCAS characterized the Corporation’s and CHTL’s failure to seek and obtain the City’s approval of the third Clarification Letter as a “technical oversight” and deemed the resulting changes in lease terms and rental payments as “reasonable and customary.” Further, DCAS maintained that these changes “would most likely have been approved by DCAS had they been presented.” However, DCAS also tacitly acknowledged that the Corporation and CHTL bypassed the required approval process and, by doing so, short-changed the City. In its response, DCAS stated, “DCAS will insist that any further changes that affect revenue calculations be subject to DCAS approval in advance in accordance with the lease. Indeed, we will also work with Carnegie Hall to achieve an equitable outcome for the technical lease violation.”



# INTRODUCTION

## Background

The Carnegie Hall Corporation (the Corporation) was established in 1960 by New York State legislation for the purpose of managing and operating Carnegie Hall as an auditorium and facility for concerts and other cultural activities<sup>1</sup>. In conjunction with this, on June 30, 1960, the City and the Corporation entered into a Master Lease agreement covering the Carnegie Hall building and the adjacent land located on Seventh Avenue at 57<sup>th</sup> Street in Manhattan. In 1987, the City allowed the Corporation to develop the Carnegie Hall Tower on the adjacent land (the Tower Property) and entered into a Restated Master Lease to cover this property. In turn, the Corporation subleased the Tower Property to Carnegie Hall Tower Limited Partnership—now known as Carnegie Hall Tower II Limited Liability Company (CHTL)—to manage and construct a 60-story office building with 548,904 square feet of commercial space.

The New York City Department of Citywide Administrative Services (DCAS) is responsible for monitoring the Master Lease and ensuring that the Corporation complies with its contractual obligations with the City. According to the Restated Master Lease, the City as landlord authorizes the Corporation to enter into a Sublease with Subtenant and to exercise the rights of landlord under the Sublease, provided that the Tenant does not alter or amend the Sublease without the City's consent.

Under the terms of the Sublease, CHTL must pay the Corporation a Base Rent equal to the greater of (a) full real estate taxes for the Carnegie Hall Tower or (b) \$3,010,350. CHTL is also required to pay the Corporation a Percentage Rent, which is 4 percent of Gross Commercial Rents less certain allowable Actual Expenses exclusions. In turn, the Restated Master Lease requires the Corporation to pay the City 70 percent of the total rents (i.e., Base and Percentage Rents) received from the Subtenant, CHTL.

The Sublease defines Actual Expenses as out-of-pocket expenses actually incurred by CHTL with respect to the operation and maintenance of the Tower Property, but only deductible from any sums received as escalations, pass-throughs, or similar charges to the extent that such compensation constitutes reimbursement. Certain lease provisions were subsequently amended by two City-approved Clarification Letters. The first Clarification Letter, dated April 26, 1993, allowed CHTL to deduct Tower Property general operating expenses, except for construction, financing, or leasing costs, from Gross Commercial Rents. These deductions were allowable only for Rental Years 1 to 10, i.e., from March 1991 to February 2001. The second Clarification Letter, dated March 1, 1994, amended only the reporting requirements. A third Clarification Letter, dated July 27, 2001, extended and expanded the deductions from Gross Commercial Rents. However, the Corporation did not submit this letter to the City for its review and approval.

The Corporation must submit annual detailed written statements setting forth all Sublease Income during the preceding fiscal year together with a copy of any audited financial statements

---

<sup>1</sup> The Carnegie Hall Society, Inc. (the Society) was also established in 1960 to support and preserve Carnegie Hall cultural benefits and activities in the fields of musical performance and musical education. The Society uses donations and its endowment funding to operate the Corporation. For financial reporting purposes, the Corporation and the Society (collectively, Carnegie Hall) prepare consolidated financial statements.

received from the Subtenant to the City. Similarly, CHTL must submit to the Corporation detailed quarterly Percentage Rent statements. For Fiscal Year 2010, the Corporation paid \$6,242,475 in Base Rent and \$656,800 in Percentage Rent to the City.

The Corporation must also pay the City a fixed annual rent of \$183,600 for the Carnegie Hall building. The City has, in lieu of rent payments, allowed the Corporation to make such payments available through its Special Program Fund (the Fund). The Fund is designated to provide special musical and cultural programs throughout the City and is monitored by the New York City Department of Cultural Affairs. Payments to the Fund are covered in a separate audit.

## Objectives

The objectives of our audit were to determine whether the Corporation:

- accurately calculated and paid the City Base Rent and Percentage Rent;
- maintained adequate internal controls over the recording and reporting of its rental revenue; and
- complied with certain other requirements of its lease agreement.

## Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit was Fiscal Year 2010 (July 1, 2009 - June 30, 2010). Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

## Discussion of Audit Results

The matters covered in this report were discussed with the Corporation, CHTL, and DCAS officials during and at the conclusion of this audit. A preliminary draft report was sent to the officials and discussed at an exit conference held on September 7, 2012. On September 13, 2012, we submitted a draft report to the officials with a request for comments. We received written responses from the Corporation officials on September 27, 2012, CHTL officials on September 25, 2012, and DCAS officials on September 28, 2012.

While the Corporation disagreed that it should pay the City \$363,521, the Corporation did not offer a basis for its position. Moreover, the Corporation tacitly acknowledged that the City was short-changed by stating that it “will work with the New York City Department of Citywide Administrative Services (DCAS) to achieve a fair and equitable resolution of this matter.”

In its response, CHTL contends that the third Clarification Letter provided for certain extensions and expansions of Gross Commercial Rent exclusions and that “the City’s consent to this change was not required and, accordingly, these items have been excluded.” However, this



letter was not expressly approved by the Corporation, i.e., it was never signed by the Corporation. More importantly, as noted, this letter was not submitted to or approved by the City. Article 34(a) of the Master Lease—which governs the Sublease—explicitly states that “Tenant may not alter or amend the Sublease without Landlord’s consent.” Because the proposed exclusions represented a material change in lease terms and rental payments due the City, the Corporation and CHTL should have formally sought and obtained the City’s approval. As noted, the Corporation and CHTL previously adhered to this requirement when modifying the Actual Expenses definition and reporting requirements in the first and second Clarification Letters, respectively.

DCAS characterized the Corporation’s and CHTL’s failure to seek and obtain the City’s approval of the third Clarification Letter as a “technical oversight” and deemed the resulting changes in lease terms and rental payments as “reasonable and customary.” Further, DCAS maintained that these changes “would most likely have been approved by DCAS had they been presented.” However, DCAS also tacitly acknowledged that the Corporation and CHTL bypassed the required approval process and, by doing so, short-changed the City. In its response, DCAS stated, “DCAS will insist that any further changes that affect revenue calculations be subject to DCAS approval in advance in accordance with the lease. Indeed, we will also work with Carnegie Hall to achieve an equitable outcome for the technical lease violation.”

The full text of the responses received from the Corporation, CHTL, and DCAS are included as addenda to this report.

## FINDINGS

Our review found that the Corporation generally maintained adequate internal controls over its accounting records and generally complied with the other requirements of the lease agreement that we audited. However, the Corporation did not report \$8,919,430 in Gross Commercial Rents of which \$363,521 in additional rent and interest for Fiscal Year 2010 is due the City. Our review found that the Corporation allowed the Subtenant to deduct a total of \$8,695,344 in expenses from its Gross Commercial Rents in excess of the amount previously approved by the City. Specifically, the Corporation inappropriately adopted certain Actual Expenses definitions provided in a third Clarification Letter that excluded a total of \$8,695,344 from the Gross Commercial Rents reported to the City without the City's review and consent. Our review also found that the Corporation did not report rent receipts totaling \$224,086. Consequently, the Corporation under-reported the Gross Commercial Rents by a total of \$8,919,430 and owes the City \$363,521 in additional rent, including interest.

Further, the Corporation did not ensure the Subtenant, CHTL, submitted the quarterly Percentage Rent statements for True-Up Payments<sup>2</sup>.

In addition, DCAS did not adequately administer the Master Lease. As the lease administrator, DCAS is responsible for monitoring the lease terms and ensuring that the Corporation complies with financial reporting and record-keeping and other requirements of its lease. Specifically, we found that DCAS allowed the expansion of Actual Expenses without verifying that a third Clarification Letter existed. Our review indicated that DCAS did not receive the third Clarification Letter for its review and approval. Nevertheless, DCAS accepted the payments without identifying the unauthorized deductions. Given that this third Clarification Letter significantly broadened the definition of deductible Actual Expenses, which, in turn, substantially modified the calculation of Percentage Rent, DCAS should have reviewed the deductions claimed and followed up to ascertain the basis of these deductions. However, DCAS did not appropriately review the increase in deductions and ensure that the rent amounts paid to the City were properly calculated and collected. As a result, DCAS was not aware of the significant increase in Actual Expenses reported by the Corporation. As noted in our review, in 2009, the Corporation deducted \$8,695,344 in excess of the allowable amount.

Further, DCAS did not review the calculation of the rental payments submitted to the City. As a result, it did not always collect the proper rent due and ensure the rent payment adjustments were made on a timely basis. Specifically, our review found that DCAS:

- Over-collected a total of \$188,776 in FY 2010 and
- Did not collect a Percentage Rent True-Up of \$237,452 in 2009.

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

---

<sup>2</sup> True-Up Payments represent variances between the estimated and the actual Percentage Rent amounts based on a reconciliation performed by CHTL.

## The Corporation Did Not Report Tower Property Gross Commercial Rents of \$8.9 Million

Our review found that the Corporation understated its Tower Property Gross Commercial Rents by \$8,919,430 because CHTL improperly deducted—with the Corporation’s approval—Actual Expenses totaling \$8,695,344 and did not report rent receipts totaling \$224,086. Consequently, the Corporation owes the City additional Percentage Rent and interest of \$363,521.

### The Corporation Improperly Allowed \$8,695,344 in Gross Commercial Rent Deductions

The Corporation inappropriately allowed the Subtenant, CHTL, to deduct \$8,695,344 from Tower Property Gross Commercial Rents. In a third Clarification Letter, dated July 27, 2001, CHTL proposed and the Corporation agreed to extend and expand the terms of the first City-approved Clarification Letter. Specifically, the parties agreed that CHTL was allowed to deduct general operating expenses beyond Rental Year 10, i.e., February 2001. Further, the parties agreed to expand the general operating expenses definition to include leasing and improvements expenses—which were specifically prohibited under the first Clarification Letter. However, the Corporation did not submit the third Clarification Letter to the City for review and approval. As noted, under Article 34(a) of the Master Lease, the Corporation may not alter or amend the Sublease without the City’s consent.

Based on our review, CHTL deducted total Actual Expenses of \$16,460,186. However, CHTL incurred eligible Actual Expenses of only \$7,764,842 as follows:

- Under the original Sublease, CHTL was allowed to deduct \$1,990,685 in Actual Expenses for sums received as escalations, pass-throughs, or similar charges to the extent that such compensation constitutes reimbursement.
- Under the terms of the first Clarification Letter, CHTL was allowed to deduct an additional \$5,774,157 for Base Rent paid to the Corporation.

However, CHTL claimed and the Corporation approved unauthorized deductions of \$8,695,344 for leasing and improvement costs and other general operating expenses. These deductions overstated Actual Expenses claimed by *112 percent*. CHTL and the Corporation accepted these deductions as allowable under the terms of the third Clarification Letter, dated July 27, 2001. However, as noted, the Corporation never submitted this letter to the City for its review and approval. Consequently, the Corporation has been improperly deducting Actual Expenses and underpaying Percentage Rent since 2001.

**CHTL Response:** In its response, CHTL contends that the third Clarification Letter provided for certain extensions and expansions of Gross Commercial Rent exclusions and that “the City’s consent to this change was not required and, accordingly, these items have been excluded. After eleven years without objection, the City is estopped from denying these exclusions.”

**Auditor Comment:** The expansion of the expense exclusion beyond Rental Year 10 without the City’s approval as required by the first Clarification Letter was inappropriate. More importantly, Article 34(a) of the Master Lease—which governs the Sublease—explicitly states that “Tenant may not alter or amend the Sublease without Landlord’s consent.” Because the proposed exclusions represented a

material change in lease terms and rental payments due the City, the Corporation and CHTL should have formally sought and obtained the City's approval. As noted, the Corporation and CHTL previously adhered to this requirement when modifying the Actual Expenses definition and reporting requirements in the first and second Clarification Letters, respectively.

Further, the Corporation's failure to enforce the Sublease terms and notify the City of CHTL's failure to comply with its Sublease obligation does not nullify the City's rights. In fact, Article 34(b) of the Master Lease directs the Corporation "to enforce the obligations of Subtenant under the Sublease . . . Tenant shall notify Landlord of any failure of Subtenant to comply with the obligations of Subtenants . . . If Tenant chooses in its reasonable business judgment not to enforce Subtenant any or all of Tenants' rights contained under the Sublease, Landlord may specifically direct Tenant to exercise specific rights against the Subtenant . . . and Tenant shall be obligated to exercise such specified rights." Therefore, the City is within its rights in directing the Corporation to enforce Sublease terms and collect all money due it.

## **The Corporation Did Not Ensure CHTL Reported Rental Revenue Totaling \$224,086**

The Corporation did not adequately monitor CHTL to ensure that it properly billed, collected, and reported rental revenue totaling \$224,086. Specifically, CHTL did not:

- Report revenues totaling \$97,287, made up of \$85,887 in late fees and \$11,400 in mail box rental revenue;
- Bill a tenant for base rent of \$60,000 because it did not reconcile tenant billing records and lease agreements;
- Document the approval for waiver of late fees totaling \$57,907 and consistently apply its late fee policy; and
- Bill a tenant for real estate taxes of \$8,892 because it did not apply the appropriate percentage rate.

CHTL did not collect and report these revenues to the Corporation and the Corporation did not adequately review CHTL's financial records to detect these understatements. Consequently, the Corporation did not report these revenues and underpaid Percentage Rent to the City. The combined effect of these understatements (the \$8,695,344 and the \$224,086) is detailed in the table below.

Calculation of Additional Percentage Rent and  
Interest Payable by the Corporation

Description	Per Corporation	Per Auditors	Difference
Gross Commercial Rents	\$46,940,621	\$47,164,707	\$224,086
Actual Expenses	(16,460,186)	(7,764,842)	8,695,344
<b>Revenue upon which Percentage Rent is Payable</b>	<b>\$30,480,435</b>	<b>\$39,399,865</b>	<b>\$8,919,430</b>
Percent Payable to the Corporation			4%
<b>Amount Underpaid to the Corporation</b>			<b>\$356,777</b>
Interest @ 18% per annum per lease agreement (5/1/10 - 7/31/12)			162,538
<b>Amount Payable by CHTL to the Corporation</b>			<b>\$519,315</b>
Percent Payable to the City			70%
<b>Amount Payable by the Corporation to the City</b>			<b>\$363,521</b>

**CHTL Response:** CHTL acknowledged that “it erred by not reporting receipts of \$97,287” but contended that CHTL is “free to collect or not collect late fees as it sees fit.” CHTL also believes that “there may be, inadvertent mathematical errors related to the administration of Tenant’s subleases. Whenever such errors are discovered, they are promptly addressed either by correctly re-billing the Subtenant . . . or, because of Tenant’s desire to maintain good relations with its Subtenants, making a decision to waive an undercharge error. It is entirely Tenant’s decision to make.”

**Auditor Comment:** We disagree with CHTL’s assertions that CHTL is free to waive any undercharge errors that were identified by this audit. According to Section 37.03(b) of the Sublease, “Should any audit performed by . . . the Comptroller . . . disclose that any Rent was understated or otherwise underpaid, then any underpayments shall be paid to Landlord within 10 days after Tenant has received notice of such underpayment from Landlord, together with interest thereon at the Late Charge Rate from the date such Rent was first due through the date upon which such Rent is finally paid.”

## The Corporation Did Not Require Submission of Quarterly True-Up Payments

The Corporation did not ensure that CHTL submitted required financial records upon which Corporation and, in turn, City rental payments were based. Specifically, CHTL did not prepare and submit to the Corporation detailed quarterly Percentage Rent statements in accordance with Sections 3.04(a) and 3.04(b) of the Sublease. According to the Sublease, the quarterly statements should specify all Tower Property Gross Commercial Rents for the applicable period, including an itemized statement setting forth all amounts excluded by CHTL for the calculation of Percentage Rent. These statements allow the Corporation to review and verify the accuracy of CHTL-reported Gross Commercial Rents and claimed exclusions. Further, these statements serve as a basis to determine whether any Percentage Rent True-Up would be due after

reconciling the quarter's records. CHTL is required to pay any additional Percentage Rent due on or before the 90<sup>th</sup> day following the last day of such lease quarter. Because the Corporation did not ensure that required quarterly Percentage Rent statements were submitted, the Corporation could not ensure that CHTL reported all rents, claimed only eligible deductions, and paid its Percentage Rent True-Up in a timely manner.

**CHTL Response:** CHTL did not disagree that “quarterly true-ups were not done. But this practice emanated from a City-approved March 1, 1994 letter agreement that dispensed with quarterly true-ups and statements for the Lease Years 1994 through 1998. The practice continued since then without objection and without detriment to Landlord or the City . . . In fact, what the annual true-ups have revealed is that Tenant OVERPAID Percentage Rent in six of the past eleven years, (by amounts ranging from \$939 to \$156,554). There were underpayments in five years in that period (by amounts ranging from \$17,097 to \$339,217).”

**Auditor Comment:** Again, CHTL chose to disregard its Sublease provisions by extending the quarterly reporting and True-Up requirements granted for 1994 through 1998 without City approval. Apparently, CHTL deviates from industry practice as a lease administrator.

## Other Matters

### DCAS Did Not Adequately Administer the Master Lease

DCAS did not adequately administer the Master Lease. As the lease administrator, DCAS is responsible for monitoring the lease terms and ensuring that the Corporation complies with financial reporting and record-keeping and other requirements of its lease. However, DCAS did not do so.

#### DCAS Did Not Adequately Review Financial Records

DCAS did not adequately review the Corporation's financial submissions and conduct reviews or audits to ensure that the Corporation retained required records, accurately reported revenues, and paid the City all money due it. Instead, DCAS relied on CHTL's external auditors' report. As noted, CHTL claimed and the Corporation approved unauthorized deductions of \$8,695,344 for leasing and improvement costs and other operating expenses. These deductions overstated the Actual Expenses claimed by *112 percent*. CHTL and the Corporation maintained these deductions were allowable under the terms of a third Clarification Letter dated July 27, 2001. However, as noted, the Corporation never submitted this letter to the City for its review and approval. Nevertheless, DCAS accepted the payments without identifying the unauthorized deductions. Consequently, the Corporation has been improperly deducting Actual Expenses and underpaying Percentage Rent since 2001. Given the significant impact of these deductions, DCAS should quantify underpaid rents and assess interest for periods prior to our audit scope.

Additionally, DCAS did not perform a review to ensure all revenue from the Tower Property was properly collected and reported to the City. As a result, the Corporation did not report a total of \$224,086 in rent receipts.

**DCAS Response:** DCAS characterized the Corporation and CHTL's failure to seek and obtain the City's approval of the third Clarification Letter as a “technical



oversight” and deemed the resulting changes in lease terms and rental payments as “reasonable and customary.” However, it stated that “DCAS will insist that any further changes that affect revenue calculations be subject to DCAS approval in advance in accordance with the lease. Indeed, we will also work with Carnegie Hall to achieve an equitable outcome for the technical lease violation. . . . DGS, now DCAS, upon concurring with the 1993 clarification agreement, apparently did not prepare a ‘tickler’ to flag this lease for closer scrutiny when reviewing the payments for rental year eleven going forward. Without such a flag, when these deductions continued in rental year eleven, and the year-end accounting was accompanied by the formal review and opinion of two CPA firms, the absence of the second agreement between Carnegie Hall and the Tower went unnoticed.”

**Auditor Comment:** We are pleased that DCAS tacitly acknowledged that the Corporation and CHTL bypassed the required approval process and, by doing so, short-changed the City. However, DCAS should reinforce its lease monitoring efforts to ensure further lease violations are prevented.

Further, DCAS should also conduct its own internal review rather than using the CPA opinion as a basis for reliance on the rent payment calculation. As our review noted, the formal review and opinion of the CPA that DCAS referred to in its response accepted the expense deductions even when the basis for the deductions, i.e., the third Clarification Letter, was missing the required signatures of both the Corporation and the City.

## **DCAS Did Not Properly Calculate and Collect the Rents Payable to the City**

DCAS did not ensure it reviewed the calculation of the rental payments submitted to the City. As a result, it did not always collect the proper rent due and ensure the rent payment adjustments were made in a timely basis. Our review of DCAS’s Account History found that DCAS improperly applied the percentage payable to the City. This resulted in DCAS over-collecting Base and Percentage Rents payable to the City by \$188,776 for the period July 2009 through February 2010.

Further, DCAS did not collect \$237,452 for the Calendar Year 2009 Percentage Rent True-Up. Based on our review of the Corporation’s current general ledger and DCAS’s Account History for the Corporation, a total of \$237,452 in rent payment remains outstanding or unpaid. As revealed on April 30, 2010, the Corporation collected \$339,217 from CHTL for the Calendar Year 2009 Percentage Rent True-Up. Of this total, the Corporation owes \$237,452 (70 percent of the \$339,217) to the City.

**DCAS Response:** “The lease was, however, identified for audit by DCAS more recently. Contrary to the assertions made in the Audit Report, DCAS proactively identified that Carnegie Hall used an incorrect percentage for calculating its rent resulting in an overpayment to the City, and also identified that Carnegie Hall had withheld a ‘true-up’ payment from the City to compensate in part. This Audit by the Comptroller’s Office started before the commencement of the planned audit of Carnegie Hall by DCAS.”

**Auditor Comment:** Although we are pleased that DCAS is planning to conduct its own audit, given the length of time that has already elapsed since the first

overpayment occurred, we recommend that DCAS resolve the identified discrepancies as soon as possible.

## RECOMMENDATIONS

To address these issues, the audit recommends that the Corporation should:

1. Pay the City additional 2009 Percentage Rent and interest of \$363,521 resulting from improperly deducted Actual Expenses and unreported Gross Commercial Rents.

**The Corporation Response:** The Corporation “disagrees with this recommendation and will work with the New York City Department of Citywide Administrative Services (DCAS) to achieve a fair and equitable resolution of this matter.”

**CHTL Response:** CHTL disagreed with this recommendation regarding “the computation of 2009 Percentage Rent.”

**Auditor Comment:** In view of the continued partnership between Carnegie Hall and the City, DCAS should act in the best interest of the City to attain a fair and equitable resolution with the Corporation.

2. Ensure it submits all proposed Sublease modifications or clarifications to the City for its review and approval prior to implementation.

**The Corporation Response:** The Corporation responded that it “will comply with the applicable provisions of its lease with the City of New York.”

**Auditor Comment:** We are pleased that the Corporation acknowledged the Sublease modification or clarification provisions of the Master Lease and agreed to comply with those requirements.

3. Ensure CHTL accurately reports its Percentage Rent and submits detailed quarterly Percentage Rent statements.

**The Corporation Response:** “With respect to ensuring CHTL submits detailed quarterly Percentage Rent statements, Carnegie Hall will work with DCAS and agree upon whether quarterly statements shall be required in the future.”

**CHTL Response:** CHTL disagreed with this recommendation regarding “the submission of detailed quarterly Percentage Rent statements.”

**Auditor Comment:** We are pleased that the Corporation agreed to work with DCAS to resolve the quarterly statements requirements.

To address these issues, the audit recommends that DCAS should:

4. Ensure that the Corporation pays the Percentage Rent and interest of \$363,521 and implements all the other audit recommendations.
5. Conduct a comprehensive review of claimed Actual Expenses for periods prior to our audit scope and quantify underpaid Percentage Rents and assess interest accordingly.

**DCAS Response:** DCAS disagreed with Recommendations 4 and 5, but “will pursue a fair and equitable resolution with Carnegie Hall that will result in an objective/impartial

calculation of rent due the City.”

**CHTL Response:** CHTL disagreed with this recommendation regarding “the computation of Actual Expenses for prior years.”

**Auditor Comment:** In view of the continued partnership between Carnegie Hall and the City, we agree that DCAS should act in the best interest of the City to attain a fair and equitable resolution with the Corporation.

6. Ensure that the Corporation submits all proposed Lease modifications or clarifications to the City for its review and approval prior to implementation and exercise due care and diligence to determine and document whether Lease modifications or clarifications are fair, equitable, and in the City’s best interests.

**DCAS Response:** “Agree. DCAS will reinforce the importance of these lease provisions with the parties involved.”

7. Periodically review the Corporation’s financial submissions and conduct reviews or audits to ensure that the Corporation accurately reports revenues and pays the City all money due it.

**DCAS Response:** “Agree. DCAS will review its risk assessment practices to ensure that larger value leases are audited more frequently.”

8. Properly bill the Corporation Base and Percentage Rents and collect any amounts due.

**DCAS Response:** “Agree. DCAS issues monthly statements for all of its leases.”

**Auditor Comment:** We are pleased that DCAS is taking the proper measures to enhance its lease administrative process.

## DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit was Fiscal Year 2010 (July 1, 2009, through June 30, 2010). To obtain an understanding of the Corporation's contractual obligations with the City, we reviewed the Master Lease between the Corporation and the City, the Restrictive Declaration, and the Joinder Agreement. In addition, we reviewed the Corporation's consolidated financial statements for the years ending June 30, 2009, and 2010, Schedule of Rent Payable to the City and related financial records for FY 2010, organizational chart, administrative handbook, and its Board of Trustees' minutes.

To obtain an understanding of the operations and management of the Carnegie Hall Tower, we reviewed the Sublease between the Corporation and CHTL, the management contract, CHTL's 2009<sup>3</sup> consolidated financial statements, audited percentage rent reports, leasing and tenant occupancy records, trial balance, general ledger, cash receipts and payment vouchers, internal controls policies and procedures, and organizational chart for the Carnegie Hall Tower.

We conducted walk-through meetings with the officials of the Corporation and management company of the Tower Property and performed an observation of the Carnegie Hall Tower. We also conducted meetings with DCAS officials to obtain an understanding of their role in the administration of the Master Lease. We documented our understanding through written narratives and flowcharts.

To perform preliminary analyses, we traced the amounts from CHTL's 2009 general ledger to the trial balance as of December 31, 2009, and compared these to the amounts reported in CHTL's financial statements for accuracy. To identify any significant fluctuations in Gross Commercial Rents and exclusions, we prepared a trend analysis based on reported information from CHTL's Schedule of Gross Commercial Rents and Exclusions. To familiarize ourselves with the Carnegie Hall Tower's leasing activities and tenant occupancy, we reviewed the Rent Roll and compared the tenants listed with those of the Stacking Plan to identify any unreported tenancy. Based on the lease terms listed in the Rent Roll and Tenant Activity Report (TAR), we summarized the tenants' occupancy during 2009. We also conducted internet research to verify the tenants' occupancy in the Carnegie Hall Tower.

To determine whether CHTL reported its rental income appropriately, we judgmentally selected a sample of 14 tenants (18 percent) from 79 tenants, consisting of 12 tenants from the 77 active office tenants and both retail tenants. We reviewed the terms and provisions stipulated in the individual lease agreements with what CHTL applied. This included re-calculating charges such as base rent, additional rent, late fees, and real estate taxes for each sampled tenant. In

---

<sup>3</sup> The Carnegie Hall's Percentage Rent to the City for FY 2010 was on a cash basis, which included the estimated Percentage Rent collected from CHTL for the second, third, and fourth estimated quarters of Calendar Year 2009 and the first quarter of Calendar Year 2010. The True-Up payment for Calendar Year 2009, which should be paid within 120 days from the end of the calendar year, would be reported in FY 2010.

addition, we compared each tenant's stated Tenant Proportionate Share per lease agreements with the occupancy percentage applied to tenants' cost allocation to determine any significant variances. To ascertain whether the receipts collected were accurately reported, we judgmentally selected the month of October 2009 and traced the sample tenants' receipts from the TAR to the cash receipts journal, to the bank's lockbox deposit report or deposit slips, and finally, to the bank statements. To determine whether CHTL collected the required security deposit amounts from its tenants, we traced the security deposit amounts from the individual lease agreements to its Letter of Credit information as of December 31, 2009, or its Security Deposit Control Account bank statement.

To ascertain whether the amount of Gross Rental Income reported in CHTL's Schedule of Gross Commercial Rents and Exclusions was accurate, we reconciled that amount with our summary of the rent revenue recorded from the TAR. Further, we compared the rent payments from individual tenants with their lease terms listed in the Rent Roll and examined whether any irregular account activities exist.

To ascertain whether CHTL's methodology for applying inclusions and exclusions to Gross Commercial Rents in its calculation of Percentage Rent was appropriate, we reviewed the Sublease with its related definitions and the three Clarification Letters. Additionally, we reviewed CHTL's Percentage Rent audited reports and support schedules to determine which items should be included or excluded per the definition of Gross Commercial Rents. To determine whether the allocated expenses claimed as reimbursements for Actual Expenses and deducted from Gross Commercial Rents were appropriately claimed, we judgmentally selected the highest amount from each expense account claimed under reimbursement for Actual Expenses and all tenant improvement expenses reported in Calendar Year 2009. For these sampled expenses, we reviewed the invoices and supporting documentation to ascertain whether the expenses were appropriate and in conformity with the definition of Gross Commercial Rents. Based on these analyses, we re-calculated the Percentage Rent due and also determined if any late fees should apply.

To determine whether the Corporation appropriately recorded Percentage Rent payments received from CHTL and subsequently appropriately calculated its payments to DCAS, we traced the receipts and disbursements records to the Corporation's FY 2010 general ledger. We assessed the Corporation's methodology for calculating the Percentage Rent and compared them with their respective lease provisions. Further, we accessed DCAS's Account History for the Corporation to ascertain whether all Corporation payments of Percentage Rent to the City were received and paid in a timely manner.

To determine whether CHTL paid the amount of Base Rent for the Carnegie Hall Tower to the Corporation properly, we re-calculated the Base Rent due per Sublease and compared it with CHTL's payment records. We then traced CHTL's payments records to the Corporation's cash receipts for consistency. To determine whether the Corporation appropriately paid the amount of Base Rent due the City, we re-calculated the amount payable according to the Master Lease and compared it with the Corporation's payment records for accuracy. Further, we compared DCAS's Account History with the Corporation's disbursement vouchers to identify any discrepancies.

To determine whether the Corporation and CHTL maintained the required insurance coverage for both Carnegie Hall and the Carnegie Hall Tower, respectively, we reviewed the provisions of the lease agreements related to insurance requirements and compared them with their annual insurance certificates. To determine whether the Corporation and CHTL properly paid their water and sewer charges to the City, we reviewed the payment history obtained from the Water



Board for all water and sewer accounts registered for Carnegie Hall and the Carnegie Hall Tower and CHTL's current payment records. We also reviewed the Department of Buildings' records to ascertain any unsettled violations.

The result of the above tests, in conjunction with our other audit procedures, while not projected to the respective populations from which the samples were drawn, provided a reasonable basis to satisfy our audit objectives.

September 27, 2012

Ms. H. Tina Kim  
Deputy Comptroller  
City of New York Office of the Comptroller  
Municipal Building  
One Centre Street, Room 1100  
New York, New York 10007-2341

RE: Draft Audit Report of the City of New York Office of  
the Comptroller dated September 13, 2012

Dear Ms. Kim:

We are in receipt of the Draft Audit Report and appreciate the opportunity to have met with you and the Department of Citywide Administrative Services to discuss the report.

Carnegie Hall greatly appreciates the continued support from the City of New York which helps this organization to fulfill its mission to present extraordinary music and musicians on the three stages of our legendary hall, to bring the transformative power of music to the widest possible audience, to provide visionary education programs, and to foster the future of music through the cultivation of new works, artists and audiences.

We respectfully disagree with a number of the conclusions in the Draft Audit Report and the basis for those conclusions.

**Response to Recommendations of the Comptroller:**

1. Response to recommendation #1 that Carnegie Hall should "Pay the City additional 2009 Percentage Rent and interest of \$363,521 resulting from improperly deducted Actual Expenses and unreported Gross Commercial Rents."

Carnegie Hall disagrees with this recommendation and will work with the New York City Department of Citywide Administrative Services (DCAS) to achieve a fair and equitable resolution of this matter.



Ms. H. Tina Kim  
September 27, 2012  
Page 2

2. Response to recommendation #2 that Carnegie Hall "Ensure it submits all proposed Sublease modifications or clarifications to the City for review and approval prior to implementation."

Carnegie Hall will comply with the applicable provisions of its lease with the City of New York.

3. Response to recommendation #3 that Carnegie Hall "Ensure CHTL accurately reports its Percentage Rent and submits detailed quarterly Percentage Rent statements."

Carnegie Hall views this as two recommendations. With respect to ensuring that "CHTL accurately reports its Percentage Rent," Carnegie Hall has complied with and will continue to comply with the applicable annual reporting requirements in Section 6a of its lease with the City of New York. With respect to ensuring CHTL submits detailed quarterly Percentage Rent statements, Carnegie Hall will work with DCAS and agree upon whether quarterly statements shall be required in the future.

Carnegie Hall looks forward to its continued partnership with the City of New York in service to its citizens.

Sincerely yours,



Clive Gillinson  
Executive & Artistic Director

CARNEGIE HALL TOWER II L.L.C.  
387 Park Avenue South, 7<sup>th</sup> Floor  
New York, New York 10016

By Federal Express  
Deputy Comptroller H. Tina Kim  
City of New York, Office of the Comptroller, Bureau of Audits  
One Centre Street, Room 1100  
New York, New York 10007-2341

September 24 , 2012

Re: September 13, 2012 Draft Audit of the Carnegie Hall Corporation's  
Compliance With Its City Lease Agreement (the "Audit Report")  
Lease dated as of December 21, 1987 between The Carnegie Hall Corporation as  
Landlord and Carnegie Hall Tower II L.L.C. (successor in interest to Carnegie Hall Tower  
Limited Partnership) as Tenant, as clarified by letters to date (the "CHTL Lease")

Dear Deputy Comptroller Kim:

Tenant writes to express its strong disagreement with several of the findings and  
recommendations in the Audit Report.

Capitalized terms not defined in this letter are defined in the CHTL Lease. Unless otherwise  
indicated, section references are to sections of the CHTL Lease and paragraph references are to  
paragraphs of the 1993 Letter (hereinafter defined).

**Response to Comment that CHTL did not report rent receipts totaling \$224,086.**

Tenant acknowledges that it erred by not reporting receipts of \$97,287. However, contrary to  
the assertion in the Audit Report that Tenant should have paid Percentage Rent on money that it did not  
collect from its Subtenants, the CHTL Lease is clear that the calculation is to be made on "rentals,  
receipts, fees ...**received**...by Tenant"<sup>1</sup>.

There is no legal requirement that a landlord extract every dollar to which it is entitled from its  
tenants. Decisions as to whether to collect late fees are based on shifting market conditions, the lease  
in question and the relationship between the landlord and its tenant. Tenant was, and continues to be,  
free to collect or not collect late fees as it sees fit. Tenant does not have a formal written policy  
regarding the collection or waiver of late fees, and does not intend to adopt any such policy as it  
believes that each such decision should be separately evaluated at the time. Similarly, if and when  
Tenant makes a Subtenant-favorable error in the computation of rent, Tenant is free to correct the error  
or let it go. From time to time, there may have been, and, in the future, there may be, inadvertent

---

<sup>1</sup> see definitions of Gross Commercial Rents and Accounting Principles



mathematical errors related to the administration of Tenant's subleases. Whenever such errors are discovered, they are promptly addressed either by correctly re-billing the Subtenant with respect to both over- and under- charges, or, because of Tenant's desire to maintain good relations with its Subtenants, making a decision to waive an undercharge error. It is entirely Tenant's decision to make.

**Response to Comment that CHTL "improperly deducted .... Actual Expenses totaling \$8,695,344".**

Tenant has relied upon two clarification letters, one dated April 26, 1993 (the "1993 Letter") which was consented to by The City of New York ("The City"), and one dated July 27, 2001 (the "2001 Letter") with respect to the exclusion of certain items from the Gross Commercial Rents on which Percentage Rent is calculated.

Paragraph 4, which does not have any stated time period and so remains in effect indefinitely, excludes certain amounts from Gross Commercial Rents whether or not they are collected as "a separately stated escalation or pass through or are part of a Subtenant's base or fixed minimum rent..." Paragraph 2 excludes 70% of Base Rent payable after Rental Year 10; Paragraph 3 excludes the items enumerated. The reference in Paragraph 3 to Rental Years 1 through 10 was intended to be read in conjunction with the last sentence of Paragraph 3, which contemplated that Landlord and Tenant would "seek to agree on a specific identification of items, similar in detail to the foregoing listing, that are to be included in Actual Expenses after Rental Year 10." City approval was not required; if it had been required the letter could easily have said so. Except for the 2001 letter, neither Landlord nor Tenant notified the other that the list needed to be changed, and Landlord and Tenant have continued to treat the items enumerated in Paragraph 3 as exclusions from Gross Commercial Rents.

The 2001 Letter added leasing commissions and the cost of rebuilding and/or renovating Subtenant space to the Paragraph 3 list of exclusions from Gross Commercial Rents. As noted above, the City's consent to this change was not required and, accordingly, these items have been excluded. After eleven years without objection, the City is estopped from denying these exclusions.

**Response to Comment that the Corporation Did Not Require Submission of Quarterly True-Up Payments.**

Tenant does not disagree with your finding that quarterly true-ups were not done. But this practice emanated from a City-approved March 1, 1994 letter agreement that dispensed with quarterly true-ups and statements for the Lease Years 1994 through 1998. The practice continued since then without objection and without detriment to Landlord or the City inasmuch as Tenant has made quarterly payments of Percentage Rent pursuant to Section 3.04 (a)(y) and there have been annual true-ups done after Tenant's submission of annual audited statements of Percentage Rent per Section 3.04(c). In fact, what the annual true-ups have revealed is that Tenant OVERPAID Percentage Rent in six of the past eleven years, (by amounts ranging from \$939 to \$156,554). There were underpayments in five years in that period (by amounts ranging from \$17,097 to \$339,217). The two years in which the amount of

underpayment of Percentage Rent were the greatest, 2009 and 2010, were attributable to Tenant's over- estimate for both subtenant work and write-offs given the bad economy in those years.

Accordingly, we respectfully disagree with your recommendations regarding the computation of 2009 Percentage Rent, the computation of Actual Expenses for prior years and the submission of detailed quarterly Percentage Rent statements.

Very truly yours,  
CARNEGIE HALL TOWER II L.L.C.

By:   
Kristin E. Sather, Senior Vice President

cc: Ted Phillips, Director of Finance, Carnegie Hall Corporation  
David Nagler, Esq. Skadden, Arps et al.  
Steven Mortman, Deputy General Counsel, NYC Department of Citywide Administrative Services (DCAS)  
Shelley Goldman, Director of Long Term Leasing, DCAS  
Teresa Ward, DCAS Chief Real Estate Assets  
Christopher Lane, DCAS Audit Director





Edna Wells Handy  
Commissioner

1 Centre Street  
17<sup>th</sup> Floor  
New York, NY 10007

212 386-0201 tel  
212 669-8992 fax

September 28, 2012

H. Tina Kim  
Deputy Comptroller for Audit  
Office of the Comptroller  
One Centre Street, Room 1100  
New York, NY 10007-2341

Re: Audit Report on the Carnegie Hall  
Corporation Compliance with its  
City Lease Agreement  
(FN12-068A)

Dear Ms. Kim:

Thank you for the opportunity to respond to the above referenced Audit Report. With respect to the Carnegie Hall lease, we believe that it is important to consider the intent of the agreement and the reasonableness of the questioned actions in order to establish an appropriate balance and to reach a fair and equitable outcome for the parties.

In 1960, the City purchased the Carnegie Hall building to rescue the legendary concert hall from demolition and ensure that its rich history and tradition of musical excellence would continue for future generations of New Yorkers and visitors to our City. In addition, the City's purchase gave rise to the unique public/private partnership that continues with the Institution today through Carnegie Hall's membership in the Cultural Institutions Group or CIG, the group of 33 cultural institutions operating in City-owned property that receive City subsidies toward operations.

In keeping with this partnership, in 1987 the City amended and restated Carnegie Hall's lease to facilitate the construction of an office tower (the "Tower") adjacent Carnegie Hall by a private party that would become Carnegie Hall's subtenant under the lease and provide a dedicated revenue source to further Carnegie Hall's mission of presenting extraordinary music and musicians on its three stages, bringing the transformative power of music to the widest possible audience, providing visionary education programs, and fostering the future of music through the cultivation of new works, artists, and audiences.

The main finding in the Audit concerns a clarification agreement to the subtenant agreement between Carnegie Hall and the Tower that was executed in April 1993 and approved by the City. Among other terms, this agreement itemized specific categories of expenses that could be used by the Tower to determine the “allowable” expenses for the initial period of the agreement. These “allowable” expenses offset the gross revenues of the Tower when calculating the “percentage rent”. The “clarification” agreement permitted the offset of specific “allowable” itemized expenses for rental years one through ten of the sublease and indicated that a subsequent agreement, with similarly itemized “allowable” expenses for revenue offset, was expected to be negotiated by the two parties before the end of rental year ten, for the period subsequent to rental year ten.

The Audit found that there was no such follow-up agreement executed between Carnegie Hall and the Tower that was approved by the City. After rental year ten, however, the Tower and Carnegie Hall did arrive at an agreement regarding the “allowable” deductions. They continued to apply not only the previously approved “allowable” adjustments to revenues, but also included certain additional adjustments.

In the absence of formal approval of the agreement by the City, a technical oversight, the Auditors have determined that most of the previously approved “allowable” expenses should not be permitted. Furthermore, they have recommended that DCAS reexamine all rental calculations for periods prior to the Audit scope, and that DCAS to the fullest extent permitted apply their methods to recalculate each year’s rent due, and also assess 18% compounded annual interest on all monies due.

We believe, however, that the following points should be afforded weight in reaching a resolution.

- The primary purpose of the City’s lease was to preserve the vital not-for-profit mission of Carnegie Hall for the citizens of and visitors to the City of New York and for posterity.
- In its approval of the April 1993 letter, the City had already judged most of the deductions to be reasonable and customary.
- The additional deductions that were agreed upon by these parties are also reasonable and customary for commercial real estate in New York City, and would most likely have been approved by DCAS had they been presented.

Therefore, the actions recommended by the Comptroller would pose too severe a penalty for a technical violation of the lease.

To be clear, DCAS will insist that any further changes that affect the revenue calculations be subject to DCAS approval in advance in accordance with the lease. Indeed, we will also work with Carnegie Hall to achieve an equitable outcome for the technical lease violation.

The Audit Report also criticizes this Agency by stating that “DCAS accepted the payments without identifying the unauthorized deduction.” DGS, now DCAS, upon concurring with



the 1993 clarification agreement, apparently did not prepare a “tickler” to flag this lease for closer scrutiny when reviewing the payments for rental year eleven going forward. Without such a flag, when these deductions continued in rental year eleven, and the year-end accounting was accompanied by the formal review and opinion of two CPA firms, the absence of the second agreement between Carnegie Hall and the Tower went unnoticed.

In fact, DCAS conducts regular audits of its leases based upon a risk assessment process, since it is not practicable to audit every lease. Notably, the City Comptroller previously audited the Carnegie Hall lease and issued an audit report on March 27, 2000 without any findings. Also, since each Carnegie Hall payment was accompanied by the review and opinion of two independent CPA firms for both the Carnegie Hall and the Tower, this lease was not initially deemed to be a high risk.

The lease was, however, identified for audit by DCAS more recently. Contrary to the assertions made in the Audit Report, DCAS proactively identified that Carnegie Hall used an incorrect percentage for calculating its rent resulting in an overpayment to the City, and also identified that Carnegie Hall had withheld a “true-up” payment from the City to compensate in part. This Audit by the Comptroller’s Office started before the commencement of the planned audit of Carnegie Hall by DCAS.

#### **Recommendations**

4. DCAS should ensure that the Corporation pays the Percentage Rent and interest of \$363,521 and implements all the other audit recommendations.
5. Conduct a comprehensive review of claimed Actual Expenses for periods prior to our audit and quantify underpaid Percentage Rents and assess interest accordingly

**Response 4 & 5:** Disagree. DCAS will pursue a fair and equitable resolution with Carnegie Hall that will result in an objective/impartial calculation of rent due the City.

6. Ensure that the Corporation submits all proposed Lease modifications or clarifications to the City for its review and approval prior to implementation and exercise due care and diligence to determine and document whether Lease modifications and clarifications are fair, equitable and in the City’s best interests.

**Response 6:** Agree. DCAS will reinforce the importance of these lease provisions with the parties involved.

7. Periodically review the Corporation’s financial submissions and conduct reviews or audits to ensure that the Corporation retains required records, accurately reports revenues, and pays the City all money due it.

**Response 7:** Agree. DCAS will review its risk assessment practices to ensure that larger value leases are audited more frequently.

8. Properly bill the Corporation Base and Percentage Rents and collect any amounts due.

**Response 8:** Agree. DCAS issues monthly statements for all of its leases.

We would like to thank the auditors for their efforts on this Audit.

Sincerely,

  
Edna Wells Handy