

**Nassau County  
Office of the Comptroller**



**Limited Review of Carlton on the Park, Ltd.'s  
Compliance with its Nassau County Licensing Agreements**

**HOWARD S. WEITZMAN**

*Comptroller*

December 8, 2009

**NASSAU COUNTY**  
**OFFICE OF THE COMPTROLLER**

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## Executive Summary

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### **Background**

Nassau County ( the “County”), acting on behalf of the Department of Parks, Recreation & Museums (“Parks”), entered into two separate licensing agreements with Carlton on the Park, Ltd. (“Carlton”), to exclusively operate the catering halls, restaurants, lounges, liquor bar, and concession services located at the old Salisbury Inn in Eisenhower Park. According to Carlton’s website<sup>1</sup>, it operates two restaurants, The Palm Court, its main restaurant, and The Clubhouse, located adjacent to Eisenhower Park’s golf course. Six separate rooms offer private dining and catered events.<sup>2</sup> The facility also has several other rooms and gardens for small gatherings.

The first agreement, which was signed in July 1995 (“1995 Agreement”) and expires in January 2016, leased the main areas of the facility to Carlton in exchange for a monthly licensing fee (“fee”). The fee, which is based on a percentage of the facility’s gross receipts, increases over the term of the agreement. The fee is subject to a fixed minimum amount, which is adjusted annually by the change in the Consumer Price Index<sup>3</sup> (“CPI”). The 1995 agreement was modified in March 2003 to require Carlton to “undertake and pay for any and all repairs and replacements, including, but not limited to, major repairs and structural repairs, in or to the portions of the County-owned building in Eisenhower Park that Carlton occupies...”<sup>4</sup> The main section of the facility (all rooms except for The Gatsby Room and The Clubhouse) is covered under the 1995 licensing agreement.

The second lease agreement, signed in June 2003 (“2003 Agreement”), leased the remaining portions of the facility – the Gatsby Room and the Clubhouse Restaurant. The 2003 Agreement was originally set to expire January 2016, but an August 2004 amendment extended the expiration date to January 2017. The terms of the second agreement call for a flat fee payment and a payment equal to a percentage of gross receipts; the percentage increases over the term of the agreement.

The required payments in effect during the audit period of January 1, 2004 through December 31, 2006, were based on the following minimum rentals and percentages of Carlton’s gross revenues:

1995 Agreement			2003 Agreement		
Period	Minimum Rent	Percentage of Gross Receipts - Amount in Excess of Minimum Rent	Period	Flat Fee	Plus - Percentage of Sales
August 2003 - July 2004	\$ 288,667	11.25%	August - December 2004	\$ 25,000	5.00%
August 2004 - July 2005	\$ 297,904	11.25%	January - December 2005	\$ 60,000	5.00%
August 2005 - July 2006	\$ 309,225	11.50%	January - December 2006	\$ 60,000	6.00%
August 2006 - July 2007	\$ 320,357	11.75%			

<sup>1</sup> <http://thecarlton.com/>.

<sup>2</sup> The Grand Ballroom, the Drawing Room, The Wine Cellar, The Tap Room, The Gatsby Room, and The Havanas Cigar Club.

<sup>3</sup> Per Parks: the US Dept. of Labor CPI for the New York-Northern NJ-LI, NY\_MJ\_CT\_PA.

<sup>4</sup> Amended and Restated Settlement Agreement and Release, June 5, 2003, § 5. Page 2.

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Carlton reported gross revenues to Parks and paid the County the following rental amounts:

	Carlton Gross Revenues Reported to Nassau County			Carlton Payments to Nassau County		
	1995 Agreement	2003 Agreement	Total	1995 Agreement	2003 Agreement	Total
2006						
Catering	\$5,407,427	\$564,665	\$5,972,092			
Restaurant	2,448,580	113,449	2,562,029			
Total	\$7,856,007	\$678,114	\$8,534,121	\$878,494	\$67,715	\$946,209
2005						
Catering	\$5,358,609	\$255,500	\$5,614,109			
Restaurant	2,490,338	53,436	2,543,774			
Total	\$7,848,947	\$308,936	\$8,157,883	\$760,639	\$55,447	\$816,086
2004						
Catering	\$6,498,363	\$0	\$6,498,363			
Restaurant	2,620,660	0	2,620,660			
Total	\$9,119,023	\$0	\$9,119,023	\$1,025,890	\$20,000	\$1,045,890
Three Year Total	\$24,823,977	\$987,050	\$25,811,027	\$2,665,023	\$143,162	\$2,808,185

\*Payments in 2005 were reduced because the County permitted Carlton to reduce its rents by \$132,000 as compensation for capital improvements made by Carlton that were not included in the scope of the original agreement.

We note that Carlton reported a significant drop in income between 2004 and 2005, primarily due to a decrease in catering revenues of approximately \$900,000. We were advised by Carlton's management that this was a result of a drop off in business, however we were unable to verify this because we were not provided with appointment books indicating utilization of the facilities. The managing partner of Carlton's CPA firm told us that Carlton had been the subject of a New York State Sales Tax audit during the audit period, but declined to provide us with a copy of that audit report. As a result, we could not determine the accuracy of the revenues reported to the State.

In addition to the required lease payments, as part of the 2003 Agreement<sup>5</sup> Carlton agreed to establish an interest-bearing checking account (known as the Repairs and Refurbishment Account) into which it would deposit 3% of the gross receipts earned under that agreement. These funds, with prior County approval, are to be used for future repairs and refurbishments. The 2003 Agreement also required an additional percentage payment of 20% if the gross revenues exceeded projected gross revenues. Sales have not yet exceeded this estimate.

Carlton retains an external bookkeeper to maintain its daily sales records, and a Certified

<sup>5</sup> 2003 Agreement, § 15 pages 20-21.

## **Executive Summary**

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Public Accounting firm (“CPA firm”) to maintain its accounting records and to prepare Carlton’s annual unaudited financial statements. The external bookkeeper provides a monthly consolidated revenues schedule to the CPA firm; the CPA firm records all adjusting journal entries into the general ledger and prepares a monthly revenue analysis. The revenue analysis is used as a source document for Carlton’s calculation of rents owed to the County. Carlton management designated the CPA firm’s managing partner as the audit team’s contact on the audit engagement; all of the auditors’ questions and requests for documentation were primarily directed to the CPA firm.

### **Audit Scope, Objective and Methodology**

The objective of our audit was to review compliance with the licensing agreements, and internal controls surrounding the collection recording and reporting of receipts. Our audit did not examine operating expenses, but focused on accuracy of the revenues reported by Carlton to the County. The period audited was January 2004 through December 2006. We compared Carlton revenues reported in its financial statements to the revenues reported to the County and reconciled to its general ledgers.

We selected from Carlton’s point-of-sale software system (“Micros”) records for review to determine how the revenues were reported, and whether the revenues reported at the cash registers were posted to the Microsoft Excel records prepared by the bookkeeper and the CPA firm, and ultimately reported to the County. We traced register receipts to the Micros reports to ensure that the system was correctly aggregating the records. We computed the licensing fee due on select revenues to corroborate the fee paid to the County.

### **Scope Limitation**

Our access to information, documentation, and employees for observation and interview was limited by Carlton. These limitations hindered our ability to perform necessary audit steps essential to assess the effectiveness of Carlton’s internal control system.

Carlton’s management did not permit us to observe the daily cash reconciliation process (a “walk-through”) or discuss the procedures with the employees who actual perform those steps, as they were performed in a real time environment. We were prohibited from interviewing key employees, specifically those who maintain the books and records and who reconcile and account for cash, and the Carlton’s external bookkeeper. We requested appointment books for catering events, but were told these did not exist. All questions regarding procedures, processes, or data had to be addressed to the CPA firm and not the employees of Carlton. All of our interaction and fieldwork took place in the CPA’s office conference room. The CPA firm’s managing partner, who was assigned as our primary contact, was at times, uncooperative when responding to our requests for information or answering our questions, verbally hostile to the auditors, and terminated our fieldwork phase before we completed all our intended audit procedures.

We obtained our understanding of the cash reconciliation procedures from the CPA firm’s managing partner; he later contacted Carlton staff by phone in his office and all of our questions were routed through him. Our understanding of all financial and accounting processes were obtained from information provided by the CPA firm. We

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requested, but were not provided with, the most recent New York State Sales Tax audit. Our audit protocol dictates that we inquire of auditees whether there were any other audits for the period under review, and if so, to provide us with copies of the audits in order to determine if anything noted would have an impact on our review.

Despite the limitations placed on the auditors, we found reportable conditions that are discussed in the audit findings and recommendations presented in this report. The scope limitations leave open the possibility that there are additional significant findings that are not reported on and the possibility that there may be compensating controls to the weaknesses identified in this report.

### **Significant Audit Findings**

Our review of revenues reported to the County and fee payments made by Carlton resulted in audit adjustments totaling \$504,885, comprising:

Underreporting of Revenues to the County	\$386,872
Valet Services - Carlton Express	46,327
Unauthorized Deductions	11,015
Erroneous Rental Computations	59,259
Discrepancies in Records	<u>1,412</u>
Total Audit Adjustments	<u>\$504,885</u>

### **Unreported Revenues due Nassau County**

Over the audit period, Carlton underreported to the County over \$4.6 million in revenues. As a result, the County is owed \$386,872, the amount that represents the percentage portion of monthly fee payments related to the underreporting of gross receipts. We compared the revenue Carlton reported in its annual financial statements to the revenues Carlton reported to the County; among the types of underreported revenue were:

- *Party Service Charges.* Revenues of \$3.3 million, representing payments by customers who had contracted for private affairs, were not reported to the County. This resulted in an underpayment of rents of \$388,030<sup>6</sup>. We credited Carlton with payments of \$1.1 million in tip expense as reported on its financial statements, resulting in the net amount due to the County of \$262,205. The 1995 Agreement did not permit the exclusion of any revenues from the operations of the restaurant and affairs while the 2003 Agreement only permitted the exclusion of service charges for which Carlton made actual payments to employees or others. Carlton's CPA firm could not provide a reconciliation accounting for the distribution of these funds.
- *Catering and Restaurant Sales.* Carlton reported \$1.6 million more in catering and restaurant sales in its general ledger than it reported to the County. Of this amount, \$1.3 million represents revenues earned from the Gatsby/Clubhouse

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<sup>6</sup> The underpayment of rents includes both the rents owed on the revenues recorded as party service charges and \$261,573 in party service charges recorded by Carlton as catering and restaurant sales (see bullet – *Catering and Restaurant Sales*).

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facilities' first year of operations. The County is owed \$66,304 as its percentage of these sales. Another \$261,573 in sales represents party service charges imposed on tax-exempt catered events that Carlton recorded as Catering Sales instead of Party Service Charges.

- *Forfeited Deposits.* Carlton recorded \$220,835 in revenue on its financial statements as Forfeited Deposits; however, these revenues were not included in the gross receipts reported to the County. As a result, we determined that Carlton underpaid the County \$24,797 on the Forfeited Deposits.
- *Gift Cards.* Carlton did not report \$86,978 to the County for revenue generated by the reduction of their gift card liability account; we estimate that Carlton underpaid the County \$9,959.
- *Commission and Vendor Income.* Carlton earns commissions and fees from vendors who do business with Carlton's customers. Carlton reported \$202,190 in such revenues on its general ledger. These earnings were not reported to the County and, as a result, the County was underpaid \$22,954.

### Valet Parking Income

Customers who contracted with Carlton for catered events were required to pay for valet parking services. Carlton required these payments to be made directly to Carlton Express, a related party with the same business address and executive management as Carlton. These revenues were not included in Carlton's financial statements or in revenues reported to the County. In addition, Carlton Express paid Carlton administrative fees totaling \$60,000 during the audit period – fees that were not included in the revenues reported to the County. We were unable to audit the amount of revenues earned through Carlton Express but were provided tax returns and a general ledger, which reflected gross receipts of \$404,606 for the audit period. Using Carlton's average fee percentage, we estimate that the County was underpaid \$46,327.

### Unauthorized Deductions to Monthly Fee Payments

Carlton made unauthorized deductions (totaling \$11,015) from the fee payments remitted to the County. These deductions, made without approval from Parks, included:

- \$6,735 for lost revenue and incurred cost that Carlton claims was due to a December 16, 2005 LIPA systems power failure. However, the agreement with Carlton, states that the "County shall not be responsible or liable for interruption or breakdown resulting from causes beyond its control and capabilities" and, thus, these deductions were not warranted.
- \$8,560 deducted from fee payments due to locker room flood damage caused by a contractor. The County Attorney's Office, however, advises that it offered to allow Carlton to deduct half (\$4,280) of the expense related to the flood.

### Repair and Refurbishment ("R&R") Account

Carlton did not establish, as required, a separate bank account or set aside three percent of gross receipts in any manner to use for the replacement or refurbishment of their facilities. Without such an account, protective clauses in the contract were not

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implemented, including a mechanism for the County's pre-approval of repair projects, County approval of the vendors selected, and County review of compliance with bidding requirements. As these controls did not exist, there was no assurance that repairs were necessary, bidding requirements were met, and that repair work was performed.

### Erroneous Computations of Fee Payments

There were occurrences of incorrect fee payments made by Carlton due to its erroneous computation of the fee. Carlton miscalculated the variable portion of rent due under the 1995 and 2003 agreements resulting in underpayments totaling \$3,346 partially offset by an overpayment of \$1,668. Carlton also deducted a base rental payment of \$20,769 from a variable rent, \$927 more than the actual payment made.

In addition, in 2006, Parks erroneously reduced the *base rent fee* by \$5,000 per month from Carlton's monthly fixed portion invoice. Parks implemented this deduction based upon a proposal (that was not finally agreed upon) to reduce the monthly rent by this amount. In total, \$60,000 was deducted. Parks notified Carlton of this billing error and instructed it to remit the difference; however, Carlton disputed the claim.

### Discrepancies Between Carlton Records and Revenue Reported to the County

Carlton's recently-updated financial record-keeping system prevented it from being able to provide monthly-consolidated reports for dates prior to August 2006, limiting our testing of sales records to just the months of September through December of 2006. In our testing of this limited time period, we noted that sales revenues for food, alcohol, tobacco, and club memberships, as recorded by Micros, did not agree to the gross sales revenues reported to the County for that same period. In addition, reclassifications of Micros restaurant sales to catering sales for selected dates tested resulted in an underreporting of revenues to the County.

### Inadequacy of Record Retention and Records

Carlton did not:

- use pre-numbered contracts or invoices, or appear to have signed contracts with all customers for catered affairs. Contracts were missing from the contract binders provided;
- retain appointment logs of catered events and, generally, had poor record retention practices;
- have a system log of payments for catered affairs. Both deposits and final payments for catered events are primarily received by check; final payments are not usually recorded in Micros and, consequently, there is no system log of these payments.
- maintain catering logs or appointment books of prior events

The lack of these records hindered our ability to ensure that all catered events were accounted for and that revenues received by Carlton were properly recorded

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### Internal Controls Surrounding Sales

As part of our review of the internal controls surrounding Carlton's sales of food and beverages, we noted that the wait staff initiated Voids, Cancel, and Error Correct transactions in the Micros system. A review of transactions over a four-month period showed there were over 10,000 voids, error corrects and cancellations, amounting to approximately \$260,000 in transactions that were processed without approvals or reconciliations of supporting documentation by management, the bookkeeper or the CPA firm.

Without management oversight of voided, cancelled, or corrected transactions:

- the internal controls surrounding these transactions are not sufficient to preclude or detect the misappropriation of funds collected at the restaurant;
- we could not be assured that transactions occurring at Carlton were accurately reflected as sales in Micros; and
- we could not be sure that the value of restaurant receipts were accurately reported to the County.

### Performance Bonds

Both licensing agreements with Carlton require securing performance bonds as security to the County for any deficiency that may arise from any default. Parks indicated that it had not received evidence of the existence of performance bonds during the audit period prior to September 2006. When we requested evidence of coverage from Carlton, it only provided a continuation certificate for one year, in an amount that was \$50,000 less than the required security; no evidence of a performance bond under the 2003 Agreement was provided.

### Compliance with Other Insurance Requirements of Licensing Agreements

Carlton did not maintain insurance coverage that complied with the requirements stipulated in the two licensing agreements. Examples where the insurance requirements were lacking include:

- Fire Legal Liability coverage was limited to \$100,000 per occurrence instead of the \$250,000 as required by the 1995 Agreement;
- Liquor Liability insurance required under the 1995 Agreement was not included in the February 2003 to February 2004 certificate;
- The 2003 Agreement required additional insurance coverage, but this coverage was not on the insurance certificates for the periods 2003-2004, 2006-2007, and 2007-2008.

### Compliance with Reporting Requirements

During the audit period, Carlton did not adhere to reporting requirements; financial statements were not provided within the time-period specified by the Agreements. In

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particular, the financial statements for the year ended December 31, 2006 were not available until after the completion of our audit fieldwork in October 2007 – a time frame that is clearly beyond the 30 and 90-day (after year end) due dates as stated in the licensing agreements

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On April 16, 2009, our Office submitted this report in draft to Carlton for comments. The matters covered in this report were discussed with Carlton management and its CPA firm during the audit and in an exit conference held on August 20, 2009. After reviewing Carlton's comments, which were received on May 26, 2009, we submitted a revised draft report to Carlton on July 21, 2009. After the exit conference, we informed Carlton management of the removal of two findings and their related recommendations; Carlton did not revise its comments for these changes made to the final report. Carlton's comments, and our responses to those comments, are included as an appendix to this report.

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**Audit Finding (1):**

**Unreported Revenues due Nassau County**

The 1995 Agreement defined gross receipts as all monies earned from the operation of the restaurant, cafeteria, bars, vending machines, special meals, and affairs.<sup>7</sup>

The 2003 Agreement states that gross receipts will include all funds generated from:

- the sale of food and beverages;
- any other sale of merchandise or service;
- orders placed with Carlton, even if the order or services to be provided are outside of the licensed facilities;
- all sales made by any other operator using the licensed facilities under an authorized sublicense or subcontract agreement; and
- rental and sublicense or subcontracting fees and commissions.<sup>8</sup>

The 2003 Agreement further states that gross receipts excludes taxes required to be collected and paid against sales: “(ii) tips, gratuities or other charges for services included in the account or bill of a patron and for which Carlton made **actual payment** [*emphasis added*] to employees or other; and (iii) monies refunded for cancelled events.”<sup>9</sup>

The two lease agreements require Carlton to report its monthly gross receipts to the County and remit the monthly minimum fixed rent along with the variable component of the rent, computed on the monthly gross receipts. According to Parks, Carlton has not provided its annual financial statements to the County, as required by both licensing agreements (see *Audit Finding 10, Compliance with Reporting Requirements*). We requested, and were provided with, the annual financial statements from Carlton’s management. We compared the amounts reported in the 2004, 2005 and 2006 financial statements to the revenues reported to the County for these same years, and noted the following significant differences:

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<sup>7</sup> 1995 Agreement § 49.

<sup>8</sup> 2003 Agreement § 2.1 (m).

<sup>9</sup> *Id.*

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## Audit Findings and Recommendations

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Table 1

<b>Revenues Reported on Carlton's Financial Statements Compared with Revenue Reported to the County</b>					
Year	Sales	Other Income *	Total Income	Total Revenue Revenues Reported to the County	Difference
2004	\$ 10,584,915	\$ 448,020	\$ 11,032,935	\$ 9,119,023	\$ (1,913,912)
2005	9,491,459	290,622	9,782,081	8,157,883	\$ (1,624,198)
2006	9,187,900	421,297	9,609,197	8,534,121	\$ (1,075,076)
Total	\$ 29,264,274	\$ 1,159,939	\$ 30,424,213	\$ 25,811,027	\$ (4,613,186)

\* Other Income included Commissions, Memberships and Other Income

We reviewed the 2004, 2005, and 2006 general ledgers and determined that Carlton did not report several categories of revenues to the County, including party service charges, some catering sales, and commission income. *Table 2* below provides the composition of the \$4.6 million difference:

## Audit Findings and Recommendations

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Table 2

<b>Carlton Revenues recorded but not reported to the County</b>	
	<b>Total audit period</b>
Party Service Charges	\$ 3,341,860
Catering Sales	1,407,955
Interest Income	162,085
Commission Income	156,073
Tip Expense	(1,098,904)
Sales of Food/Liquor Gatsby/Clubhouse	153,107
Settlement Income	44,325
Forfeited Deposits	220,835
Restaurant & Liquor Sales, Memberships & Tobacco	22,550
Administrative Income	60,000
Vendor Fee Income	46,117
Other income - Gift Certificates	86,978
Other income (a)	10,202
Rounding	3
<b>Total revenues not reported to Parks</b>	<b>\$4,613,186</b>

Note (a): Other Income includes Room Rental revenues, Sales of Tobacco in Clubhouse/Gatsby, Miscellaneous Sales and Part Cancellation Fees.

Source: Carlton general ledgers

In addition to the revenue listed in the above table, we identified other sources of potential revenues that were not reported to the County at all:

- valet parking fees;
- other intercompany transactions that may involve revenue items.

Valet parking fees are discussed below. We could not determine if there were any revenues due to the County from other intercompany transactions as the revenues were not recorded by Carlton. Without reviewing the related parties' books and records, we could not quantify amounts of additional revenues due to the County, if any.

### *Party Service Charges*

As illustrated in Table 2 above, from 2004 to 2006, Carlton's financial statements reported over \$3.3 million of party service charges as revenues. In addition, Carlton recorded \$261,573 representing party service charges for non-taxable events as Catering Sales for a total of \$3.6 million in total party service charges (see Table 3). Carlton did not report any of these earnings to Parks.

## Audit Findings and Recommendations

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Party service charges originate from private affairs held at Carlton; these charges primarily ranged from 18% to 20% of the total invoiced amount. According to Carlton's CPA, these charges are used to pay wages and gratuities for employees and management. Party service charges, to the extent that they were not distributed to employees as gratuities, should have been reported to the County in Carlton's gross revenues. This position is consistent with the language of the 2003 Agreement, which permits Carlton to exclude from reported revenue only tips or service charges added to a bill "for which Carlton made actual payment to employees or others."<sup>10</sup> The 1995 Agreement does not permit any exclusion of revenues from operation of the restaurants or affairs.

New York State regulations concerning sales tax state that sales tax must be paid on party service charges unless the service charges are actually paid to employees: "The regulations require that for a gratuity or service charge to be exempt from the imposition of sales tax, the charge must be separately stated on the customer invoice, specifically designated as a gratuity and all such monies received must be paid over to the employees."<sup>11</sup> In a court case determined by the New York State Division of Tax Appeals, whereby the banquet service charges were shown separately on each invoice, and the percentage to be distributed to the employees was clearly indicated on the invoice, the court held that the sales tax was only payable on the portion of the service charge that was distributed to management, because this portion represented income to the business.<sup>12</sup>

Consistent with New York State Tax Law, Carlton pays sales tax on the entire party service charge according to the Carlton's CPA firm.

When the auditors indicated to the CPA firm that Carlton should have reported the party service charges to Parks as gross receipts, the CPA firm responded that these funds were distributed to employees. However, when the auditors requested a reconciliation to substantiate the distribution to employees, the CPA firm responded in writing that there was no way to reconcile or show how the service charges were allocated. According to Carlton's 2006 financial statements, Carlton "leases" a portion of its workforce from a related party.<sup>13</sup>

If the party service charges had been included as part of gross receipts during the audit period, Carlton should have paid to the County an additional \$388,030. (see *Table 3* below):

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<sup>10</sup> 2003 Agreement: § 2.1 m

<sup>11</sup> 20 NYCRR 527.8[1]

<sup>12</sup> <http://www.nysdta.org/Determinations/820355.det.pdf>, Jing Fong Restaurant, Inc., Shui Ling Lam and Chung Tsui, DTA Nos. 820355,820356,820357 and 830358 for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 2000 through May 31, 2003.

<sup>13</sup> Carlton on the Park, Ltd. Financial Statements and Accountant's Review Report: December 31, 2006 and 2005. Note 9 – Related Party Transactions p 12

## Audit Findings and Recommendations

<b>2003 Agreement Gross Receipts - Party Service/Surcharge</b>					
Year	Total Gross Receipts - Taxable events (a)	Total Gross Receipts - Non-Taxable Events (b)	Total Gross Receipts	% of Gross Receipts Due County	Total Due to the County
2004	\$ 88,483	\$ 20,503	\$ 108,986	5.00%	\$ 5,449
2005	108,890	47,061	155,951	5.00%	7,798
2006	111,310	1,573	112,883	6.00%	6,773
<b>Total</b>	<b>\$ 308,683</b>	<b>\$ 69,137</b>	<b>\$ 377,820</b>		<b>\$ 20,020</b>
<b>1995 Agreement Gross Receipts - Party Service/Surcharge</b>					
Year/Months	Total Gross Receipts - Taxable events (a)	Total Gross Receipts - Non-Taxable Events (b)	Total Gross Receipts	% of Gross Receipts Due County	Total Due to the County
2004	\$ 1,095,124	\$ 61,974	\$ 1,157,098	11.25%	\$ 130,174
Jan 05 - July 05	501,209	47,542	548,751	11.25%	61,734
Aug 05 - Dec 05	422,612	22,170	444,782	11.50%	51,150
Jan 06 - July 06	509,924	33,269	543,193	11.50%	62,467
Aug 06 - Dec 06	504,308	27,482	531,790	11.75%	62,485
<b>Total</b>	<b>\$ 3,033,177</b>	<b>\$ 192,436</b>	<b>\$ 3,225,614</b>		<b>\$ 368,010</b>
<b>Total both agreements</b>	<b>\$ 3,341,860</b>	<b>\$ 261,573</b>	<b>\$ 3,603,433</b>		<b>\$ 388,030</b>

*Source: Carlton general ledger and licensing agreements*

*Note (a): Taxable events are catered events and private parties that are subject to sales tax.*

*Note (b): Non-taxable events are catered events and private parties that are not subject to sales tax (i.e., customer is not-for-profit). The party service charges collected for these events were reported in the Catering Sales general ledger account and not in the party service charges account.*

### *Catering and Restaurant Sales*

During the audit period, Carlton reported \$1,583,612<sup>14</sup> more in catering and restaurant sales in its general ledger than it reported to Parks. Of this amount, \$261,573 represented party service charges for tax-exempt catered events that took place during the audit period and were recorded as Catering Sales instead of party service charges. Audit findings regarding this amount are included in the *Party Service Charges* section above. The remaining difference of \$1,322,039 is comprised of the following:

<sup>14</sup> Consisting of \$1,407,955 in catering sales, \$153,107 in sales of Food/Liquor at the Gatsby/Clubhouse and \$22,550 in miscellaneous adjustments to Restaurant and Liquor Sales, Memberships and Tobacco totaling \$1,583,612.

## Audit Findings and Recommendations

### Gross Receipts Not Reported to County

Table 4	Total audit period	Due to 1st year of Gatsby	Difference
Catering Sales	\$ 1,407,955	\$ 1,172,971	\$ 234,984
Less: Party Service Charges from tax-exempt events (a)	(261,573)		(261,573)
Corrected Catering Sales	\$ 1,146,382	\$ 1,172,971	\$ (26,589)
Sales of Food/Liquor Gatsby/Clubhouse	153,107	120,792	32,315
Misc. Adjustments to Restaurant & Liquor Sales, Memberships & Tobacco	22,550	32,314	(9,764)
Total Catering and Restaurant Sales underreported	\$ 1,322,039	\$ 1,326,077	\$ (4,038)

Source: Carlton general ledgers 2004 - 2006 and external accountant monthly sales worksheets

(a) Party Service Charges for tax-exempt catered events were included in Catering Sales. These revenues were discussed above in Party Service Charges.

We identified that \$1,326,077 (catering, restaurant, and tobacco sales) of the discrepancy consisted of revenues earned under the 2003 Agreement. The 2003 Agreement leased the remaining portions of the facility, known as the Gatsby Room and the Clubhouse Restaurant and required Carlton to pay, in addition to a flat fee, "...the applicable percentage of Gross Receipts derived from the operation of the Licensed Premises, all payable on a monthly basis. The licensee shall pay, commencing on February 18, 2004, and each month thereafter, the percentage fee for gross receipts based on the Gross Receipts generated during the preceding calendar month."<sup>15</sup> We found that Carlton did not report to the County the gross receipts earned at the Gatsby/Clubhouse facilities for the period of July 2004 through July 2005 even though July 2004 was the first month that Carlton recorded sales for these facilities.

According to our examination of Carlton's records, the total gross receipts for the Gatsby/Clubhouse facilities that were not reported to the County during July 2004 to July 2005, was \$1,326,077; during this period, the percentage portion of the fee was 5% of gross receipts. Consequently, Carlton underpaid the County by \$66,304 based on these sales alone.

Carlton's management indicated that Carlton was to postpone paying the percentage portion of the fee until August 2005. We noted that an amendment to the 2003 Agreement postponed the payment of the fixed portion of the monthly licensing fee; however, there was no provision in the amendment that postponed the percentage fee.<sup>16</sup> We confirmed with the Deputy County Attorney assigned to Parks that there was no

<sup>15</sup> 2003 Agreement. § 4.1 Page 5-6.

<sup>16</sup> 2003 Agreement, Amendment 1, Item 2.

## **Audit Findings and Recommendations**

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separate agreement regarding a deferment of the percentage portion of the monthly fee, and that any revenue generated by Carlton during that period would be subject to the percentage fee payment.

The remaining difference of \$(4,038) represents the net of miscellaneous unreconciled differences between the financial statements and revenues reported to the County.

### *Valet Parking Income*

Carlton offered valet parking as a service to guests of the restaurant. The valet company, Carlton Express, is a related party, and shares the same business address and executive management as Carlton. Customers who contracted with Carlton for catered events were charged for valet parking services; the invoices showed a separate fixed charge for valet parking, determined by the number of guests.

According to Carlton's management, customers must provide a separate check to Carlton, payable to the valet company. The revenues paid to the valet company were not included in Carlton's financial statements; however, the valet company paid Carlton administrative fees of \$12,000 in 2004 and \$24,000 each year for 2005 and 2006. These administrative fees were not included in the revenues reported to the County. We requested a copy of the contract(s) between Carlton Express and Carlton but, according to Carlton's CPA firm, no contract existed between the two companies.

We were unable to audit the amount of revenues earned through valet parking by Carlton Express, although we were provided with the entity's tax returns and a general ledger, which reflected gross receipts of \$404,606 for the audit period. Using Carlton's average fee percentage for the audit period of 11.45%<sup>17</sup>, we estimate that the County was underpaid by \$46,327. As part of our testing, we requested that Carlton provide records of the scheduling of valet parking. We wanted to compare records of the scheduling of catered events to the scheduling of valet parking for consistency. The CPA firm informed us that records of scheduling of valet parking services did not exist and, because the valet company was a separate company, we did not have the authority to audit any of the valet company's records. As a result, we could not verify that all the revenue reported by Carlton Express was generated by functions of Carlton. We noted that approximately \$169,000 of valet parking revenues was paid directly to Carlton, rather than Carlton Express. Based upon the documentation provided to us, we could not determine if these revenues were included in the \$404,606 gross receipts reported above.

According to Section 51 of the 1995 Agreement, Carlton is permitted to offer its customers valet parking services; however, the cost is not to exceed four dollars per car and any revisions to this charge requires approval from the Commissioner of Parks. In consideration of the fact that the agreement specifically mentions valet parking, cites a

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<sup>17</sup> This represents the average licensing fee under the 1995 Agreement for the audit period; the 2003 Agreement was not considered for this computation as valet parking is predominately related to catering.

## Audit Findings and Recommendations

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maximum amount that may be charged for the service, and imposes the requirement that the Parks Commissioner authorize adjustments to the valet parking charge, it appears that the intent of the agreement was to include valet parking revenues as part of the reportable income to the County. The fact that Carlton chooses to flow these revenues through to a related party does not absolve Carlton from its responsibility to report those revenues to the County. Consequently, any revenues recorded by the valet parking company earned from events booked by the Carlton, should be included in the gross revenues reported to the County when computing the fee in accordance with the agreements.

### *Forfeited Deposits*

During the audit period, we found that Carlton had recorded \$220,835 as income on its financial statements as forfeited deposits; however, these revenues were not included in the gross receipts reported to the County.

Upon signing a contract with a customer for a catered event or private party, Carlton collects a non-refundable deposit. These deposits are shown as liabilities in Carlton's general ledger and the revenues are recognized when the services are provided (i.e., the event takes place). If a scheduled event is cancelled, Carlton has the right to retain the deposit.

The 2003 Agreement specifically states that gross receipts should not include "monies actually refunded for cancelled events."<sup>18</sup> Consequently, deposits that are not refunded should have been reported to the County and the corresponding fee related to those earnings should have been remitted to the County. The 1995 Agreement does not exclude any earnings from reportable gross receipts.

Based upon the monthly worksheets maintained by the CPA firm and the amounts recorded in the general ledger, we determined that Carlton underpaid to the County on the forfeited deposits \$24,797, as computed in *Table 5* below:

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<sup>18</sup> 2003 Agreement, § 2.1 (m).

## Audit Findings and Recommendations

Table 5

2003 Agreement - Forfeited Deposits			
Year	Total Forfeited Deposits	% Due County	Total Due County
2004	\$ 500	5.00%	\$ 25
2005	5,575	5.00%	279
2006	3,800	6.00%	228
<b>Total</b>	<b>\$ 9,875</b>		<b>\$ 532</b>

1995 Agreement - Forfeited Deposits			
Year -Months	Total Forfeited Deposits	% Due County	Total Due County
2004	\$ 28,631	11.25%	\$ 3,221
Jan 05 - July 05	4,850	11.25%	546
Aug 05 - Dec 05	85,055	11.50%	9,781
Jan 06 - July 06	55,276	11.50%	6,357
Aug 06 - Dec 06	35,988	11.75%	4,228
<b>Subtotal</b>	<b>\$ 209,800</b>		<b>\$ 24,133</b>
Forfeited Deposits reported in general ledger but not reported in accountant's worksheet (adjusting journal entries):			
Feb 05 - May 05	600	11.25%	68
Sept 05 - Feb 06	560	11.50%	64
<i>Total Other</i>	\$ 1,160		\$ 132
<b>Total</b>	<b>\$ 210,960</b>		<b>\$ 24,265</b>
<b>Total Forfeited Deposits</b>			
	<b>\$ 220,835</b>		<b>\$ 24,797</b>

### Gift Cards

Carlton did not report \$86,978 of revenue to the County, generated by the reduction of the gift card liability account.

Carlton sells gift cards that may be used without expiration. The sale of a gift card is recorded in the general ledger as a liability. Gift card sales are not reported to the County because the payments received are not recorded as revenue by Carlton until the gift card is used. When the gift card is redeemed, the liability is eliminated and the sale is recognized as revenue and included in the total sales reported to the County.

In December 2006, a general journal entry was processed to adjust the gift card liability account. As a result, the liability account was reduced, and \$86,978 was recorded by Carlton as revenue. However, this revenue was not reported to the County as part of the monthly gross receipts. Consequently, Carlton underpaid the County \$9,959, estimated as

## Audit Findings and Recommendations

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the gift card income reported in 2006 multiplied by Carlton's average fee percentage for the audit period of 11.45%<sup>19</sup>.

### *Commission Income*

During the audit period, Carlton's general ledger included \$156,073 (\$109,759 in 2004, \$725 in 2005, and \$45,589 in 2006) of commission income that was not included in the gross receipts reported to the County. According to Carlton's CPA firm, these revenues represent the fees charged to vendors that are listed in Carlton's book of recommended service providers. Consistent with the definition of gross receipts in the 1995 Agreement, commission income is reportable to the County.<sup>20</sup> The 2003 agreement specifically states that commission income is reportable as gross receipts and included in the computation of the fee due the County.<sup>21</sup>

Consequently, Carlton underpaid the County \$17,674, computed as follows:<sup>22</sup>

Table 6

<b>Carlton - Commission Income</b>			
<b>Year -Months</b>	<b>Total Gross Receipts</b>	<b>% of Gross Receipts Due County</b>	<b>Total Due County</b>
2004	\$ 109,759	11.25%	\$ 12,348
Jan 05 - July 05	394	11.25%	44
Aug 05 - Dec 05	331	11.50%	38
Jan 06 - July 06	45,218	11.50%	5,200
Aug 06 - Dec 06	371	11.75%	44
<b>Total Commission Income</b>	<b>\$ 156,073</b>		<b>\$ 17,674</b>

Sources: Carlton 2004 - 2006 general ledgers; 1995 Agreement

The commission income reported by Carlton in its financial statements exhibits a significant fluctuation in the audit period, however, this variance was not explained.

Some of these vendors also paid vendor fees to Carlton (see the *Vendor Income* section below).

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<sup>19</sup> This represents the average licensing fees under the 1995 Agreement for the audit period; the 2003 Agreement was not considered for this computation as gift certificates are primarily redeemed for restaurant sales.

<sup>20</sup> 1995 Agreement, § 49.

<sup>21</sup> 2003 Agreement, § 2.1 (m).

<sup>22</sup> The percentage used in the computation is from the 1995 Agreement.

## Audit Findings and Recommendations

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### *Vendor Income*

For the audit period, Carlton reported \$46,117 as vendor fee income on its general ledger; these earnings were not reported to the County. Of this amount, \$43,117 were customer deposits for catered events that were erroneously booked to the vendor income account in 2005. Had the customer deposit been recorded correctly, the deposit would have been recorded as a liability, and the revenues would have been reported as sales in the month that the event took place. An adjustment was made to record these deposits as income during 2006; however, these revenues were not included in the gross receipts reported to the County. As a result, the County was underpaid \$5,280.

### *Other Income*

The remaining balance of \$10,202 that was not included in the revenues reported to the County is comprised of the following: room rentals (\$2,460); miscellaneous sales (\$7,282); and cancellation fees (\$460). Excluding the cancellation fees of \$460, Carlton should have reported an additional \$9,742 to the County during the audit period; using the average fee rates for the audit period would have resulted in an additional fee payment of \$1,115.

### *Carlton Revenues appearing in financial statements but not reportable to County*

We have excluded the following revenues from gross receipts (these amounts were not audited):

- \$1,098,904 of Tip Expense<sup>23</sup>
- \$162,805 of Interest Income
- \$60,000 in Administrative Income from Carlton Express<sup>24</sup>
- \$44,325 in Settlement Income

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<sup>23</sup> As part of the computation of the licensing fee due the County, we considered Tip Expense to be a reduction of reportable revenues.

<sup>24</sup> The Administrative Income reported on the financial statements were paid to Carlton from Carlton Express, the related-party valet company. We found that Carlton should have included Carlton Express' Valet Fees

## Audit Findings and Recommendations

### Summary

The following table illustrates the total revenues not reported to the County and the associated fee not paid to the County.

<b>2004-2006</b>				
<b>Carlton Revenues that should have been reported to the County and associated licensing fees due County</b>				
	<b>Total audit period</b>	<b>reclassifications</b>	<b>Adjusted balance</b>	<b>Related Licensing Fee</b>
Party Service Charges	\$ 3,341,860	\$ 261,573	\$ 3,603,433	\$ 388,030
Tip Expense (a)	(1,098,904)	-	(1,098,904)	(125,825)
Total Catering & Restaurant Sales	1,587,650	(261,573)	1,326,077	66,304
Commission Income	156,073		156,073	17,674
Forfeited Deposits	220,835		220,835	24,797
Vendor Fee Income	46,117		46,117	5,280
Other income - Gift Cards/Certificates	86,978		86,978	9,959
Other income (b)	10,202		10,202	1,115
Other intercompany Transactions	unknown		unknown	unknown
Total Catering & Restaurant Sales Over-reported to the County (Source: Table 4)	(4,038)		(4,038)	(462)
Rounding	3		3	
<b>Total revenues not reported to the County (c)</b>	<b>\$ 4,346,776</b>	<b>\$ -</b>	<b>\$ 4,346,776</b>	<b>\$ 386,872</b>
Carlton Express	404,606		404,606	46,327
<b>Total Revenues not Reported to County (including Carlton Express)</b>	<b>4,751,382</b>		<b>4,751,382</b>	<b>433,199</b>

Note (a): Credit for the fee for Tip Expense was computed using average rate for audit period.

Note (b): Other Income includes Room Rental revenues, Sales of Tobacco in Clubhouse/Gatsby, Miscellaneous Sales and Part Cancellation Fees.

Note (c): These totals do not include: Interest Income (\$162,085), Administrative Income (\$60,000) and Settlement Income (\$44,325). These totals combined with the total revenues not reported to the County as per Table 7 reconcile to the \$4.6 million not reported as per Table 1.

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## Audit Findings and Recommendations

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### **Audit Recommendations:**

Carlton should remit to Nassau County \$433,199 representing the percentage portion of monthly fee payments related to the underreporting of gross receipts, and comprised of the items summarized in *Table 7* above:

- a) \$388,030 resulting from party service charges;
- b) a credit of \$125,825 representing tip expenses reported;
- c) \$66,304 related to the income earned in first year under 2003 Agreement;
- d) \$17,674 related to commission income;
- e) \$5,280 related to customer deposits for catered events incorrectly recorded as vendor fee income;
- f) \$24,797 resulting from forfeited deposits;
- g) \$9,959 resulting from the write-off of the gift cards/certificates liability;
- h) \$1,115 related to other income; and
- i) \$46,327 related to Carlton Express valet parking.

Carlton should:

- a) include all forfeited deposits in calculation of rent;
- b) include any intercompany revenues generated at its facilities in its calculation of rent; and
- c) ensure that all adjusting entries made to the general ledger that affect gross receipts:
  - i. be reported to the County and included in the computation of the County fee; and
  - ii. are properly supported by a reconciliation that is retained for audit purposes.

**Audit Finding (2):**

**Unauthorized Deductions to Monthly Fee Payments**

During the audit period, Carlton made numerous unauthorized deductions from the payments remitted to the County

- Carlton claimed it lost revenue and incurred costs of \$6,735 due to a power failure that occurred on December 16, 2005. According to a letter written by Carlton's management, a catered affair was interrupted due to a power failure caused by a LIPA systems failure. Carlton deducted \$3,218 in December 2005 and \$3,517 in February 2006 from its fee payments. Section 9D of the 1995 Agreement states: "The maintenance and operation of utility facilities (except telephone) will be furnished by County with reasonable promptness and efficiency, but County shall not be responsible or liable for interruption or breakdown resulting from causes beyond its control and capabilities." We confirmed with Parks and the County Attorney's Office, that these deductions were not authorized and that the funds are due the County.
- Carlton deducted \$8,560 from its June 2005 fee payment. According to a memo from Carlton's management to the Commissioner of Parks, dated May 17, 2005, a contractor working on the ladies' locker room had caused a flood. The County Attorney's Office has advised us that it has offered to permit the Carlton to deduct half (\$4,280) of the expense incurred from its June 2005 payment.

In September 2007, the Deputy County Attorney assigned to Parks indicated to the auditors that Parks would inform Carlton that any future deductions must be submitted in writing, and Parks would make a decision whether to authorize the deduction within 90 days. As a result of the unauthorized deductions, the County is due \$11,015.

**Audit Recommendations:**

Carlton should:

- a) obtain prior written approval from Parks for any deductions or adjustments to the monthly fee; and
- b) remit \$11,015 representing the unauthorized deductions taken during the audit period.

**Audit Finding (3):**

**Repair and Refurbishment (“R&R”) Account**

The 2003 Agreement required Carlton to “set aside annually three percent (3%) of Gross Receipts for new, replacement and minor refurbishment of the facilities of the Licensed Premises and related equipment.”<sup>25</sup> The 2003 Agreement also required Carlton to establish a separate bank account, titled “Eisenhower Park 19<sup>th</sup> Hole R&R Account” for the sole purpose of holding these funds, with withdrawals made only upon the signature of County and Carlton authorized designees.

We found that Carlton did not establish the separate account or set aside funds in any other manner to use for the replacement or refurbishment of the facilities. Note eight of Carlton’s 2006 financial statements<sup>26</sup> states that “The Company is required to set aside annually the sum of three percent of the gross receipts for new, replacement and minor refurbishment of the facility.”<sup>27</sup> The 2007 financial statements included the same statement with the following added: “In lieu of using a sinking fund, management has elected to pay for the new replacement and minor refurbishment of the facility as needed.”<sup>28</sup> Parks officials confirmed that the R & R Account is still a requirement of the 2003 Agreement.

Without the R&R Account, protective clauses in the contract were not implemented, including pre-approval of the repair projects by the County, County approval of the vendors and County review of compliance with bidding requirements. Without these controls, we could not be assured that all repairs were necessary, bidding requirements were met, and that the repairs were performed.

**Audit Recommendations:**

Carlton should work with Parks to determine the total amount that should be deposited into the R&R account, since the inception of the agreement. All supporting documentation for the repairs should be provided to Parks prior to determining the required balance. Going forward, Carlton should ensure that this account is funded and administered as required by the 2003 agreement.

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<sup>25</sup> Replacement and Refurbishment Account § 15.1 page 20

<sup>26</sup> Received subsequent to the completion of our fieldwork.

<sup>27</sup> Carlton on the Park, Ltd. Financial Statement & Accountant’s Review Report December 31, 2006 and 2005: note 8 p. 12

<sup>28</sup> Carlton on the Park, Ltd. Financial Statement & Accountant’s Review Report December 31, 2007 and 2006: note 7 p. 11

**Audit Finding (4):**

**Erroneous Computations of Fee Payments**

Our audit noted several occurrences of an incorrect fee payment by Carlton due to the erroneous computation of the fee.

During certain periods, Carlton miscalculated the variable portion of rent under the 1995 and 2003 agreements.

- For November 2005, Carlton paid its rent for the 1995 agreement using a rate of 11.75% instead of the required 11.50%. This resulted in an overpayment of \$1,668.
- For January through June 2006, Carlton used 5% of Gatsby/Clubhouse gross receipts when the rate should have been 6%. This resulted in an underpayment to the County of \$3,002. For the first quarter of 2007, Carlton paid 6% of the Gatsby/Clubhouse gross receipts when the rate for that period was 6.5%; this resulted in an underpayment of \$344.
- Carlton made a base rental payment of \$20,769 for the (fixed portion) of its lease in July 2006; however when it deducted this base payment from the total payment owed based on a percentage of revenues, it deducted \$21,696, or \$927 more than it had paid.

At our prompting, Parks notified Carlton regarding the underpayments cited above and Carlton remitted the amount owed. According to Parks, in May 2007, the County received \$3,346 from Carlton representing the underpayment of revenues for the first half of 2006 (\$3,002) and the first quarter of 2007 (\$344). The overpayment of \$1,668 and underpayment of \$927 were still open as of the date of this report.

**Base rent fee**

Each of the licensing agreements includes a monthly fixed fee due to the County. Under the 1995 Agreement, the fixed component is a minimum rent initially set in the agreement and increased annually based on the CPI.<sup>29</sup> Under the 2003 Agreement, the fixed portion is \$5,000 per month. Parks invoices Carlton monthly for the fixed portion of the rent.<sup>30</sup>

An August 2004 amendment to the 2003 Agreement deferred the payment of the fixed portion of the fee from June 2003 to August 1, 2004.<sup>31</sup> Parks was to commence billing Carlton for the \$5,000 fixed portion in August 2004; however, according to Parks, it did not begin billing Carlton until September 2004. This resulted in an underpayment of the fee due the County of \$5,000. Upon notification by our office to Parks, Carlton was notified of the underpayment, which was remitted in January 2008.

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<sup>29</sup> 1995 Agreement § 41(a) p 15

<sup>30</sup> 2003 Agreement, § 4.1 p. 6

<sup>31</sup> Amendment 1 to the 2003 Agreement, § 2

## **Audit Findings and Recommendations**

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In 2006, Parks erroneously deducted \$5,000 per month from the monthly fixed portion invoiced to Carlton, based upon a proposal to reduce the rent by this amount each month. In total, \$60,000 was deducted: \$30,000 from the 1995 Agreement base rent (May 2006 through October 2006 invoices) and \$30,000 from the 2003 Agreement's fixed fee (April 2006 through September 2006 invoices). Parks notified Carlton's management that there had been an error and instructed Carlton to remit the difference; however, Carlton disputed the claim.

### **Audit Recommendations:**

Carlton should:

- a) repay the outstanding \$60,000 due the County; and
- b) seek Park's approval to deduct \$741 from any monies due the County, representing the net of:
  - i. the \$927 excess in the deduction from gross receipts for July 2006 under the 1995 Agreement; and
  - ii. \$(1,668) representing the overpayment by Carlton for November 2005.

**Audit Finding (5):**

**Discrepancies Between Carlton Records and Revenue Reported to the County**

The agreements between Carlton and the County permit the County Comptroller's Office and Parks access to Carlton's books and records. The 2003 Agreement requires that Carlton maintain and retain "complete and accurate records, documents, accounts, and other evidence, whether maintained electronically or manually"<sup>32</sup> relevant to performance.

Carlton uses a point-of-sale software system, known as "Micros", to record sales of food, beverages, and gift cards, and to account for deposits collected for private affairs. Daily reports are generated by the system to show the aggregate transactions by room, category and in total. Manual "tip-out" forms are used to determine how tips are to be distributed at the end of each shift.

Carlton uses an outside bookkeeper to maintain the daily records transacted by the restaurant and catering facility. The bookkeeper, using the daily Micros reports, transcribes this information into a monthly Microsoft Excel worksheet that categorizes each item by the respective accounts, which are used for general ledger purposes. The bookkeeper's worksheet is also given to Carlton's CPA firm who prepares a monthly worksheet that is used as the basis for general journal entries and for computing the reportable gross receipts and corresponding fee that is paid to the County each month.

Carlton prohibited us from interviewing its staff as part of our business process review, which is a normal procedure in our audits. Instead, Carlton provided us with current daily sales reports for the first week in June 2007 to provide us with some understanding of how cash receipts were reconciled each day. We did not conduct any formal examination or test of the days' daily reconciliations. However, to gain an understanding of how the bookkeeper's records were derived, we compared the sales reported by the Micros point-of-sale system to the sales reported by the bookkeeper for three of the seven days provided. At our request, we received daily Micros reports for 18 days of the three-year period (three days per month, two months per year). Our testing included comparing the Daily Revenue Center Sales Detail (Micros report) to the bookkeeper's monthly worksheet.

In order to test the adequacy of internal controls and to ensure that sales recorded per the point-of-sale system were correctly reported to Parks, we sought to compare the monthly consolidated Micros sales reports for the audit period to the sales reported in the bookkeeper's monthly Excel worksheets. We then compared the bookkeeper's worksheets to the records generated by the CPA firm. However, Carlton's CPA firm informed us that their system had been updated and monthly-consolidated reports could not be printed for dates prior to August 2006. Consequently, our sample for this test was restricted to September through December 2006 (see *Audit Finding (9) Inadequacy of Record Retention and Records*).

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<sup>32</sup> 2003 Agreement, § 4.6

## Audit Findings and Recommendations

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Sales revenues for food, alcohol, tobacco, and club memberships,<sup>33</sup> as recorded by Micros, did not agree to the gross sales revenues reported to the County. There were differences noted in each of the four months tested.

- September 2006 - Micros reports accounted for combined sales of \$207,975, while both the bookkeeper's and the CPA firm's worksheets reported sales of \$197,720 (a difference of \$10,255 underreported gross receipts to the County). The bookkeeper reported \$10,657 more in customer deposits than were reported by Micros.
- October 2006 – Micros reports accounted for combined sales of \$171,396; both the bookkeeper's and the CPA's worksheets reported sales of \$171,318 (a difference of \$78 underreported to the County).
- November 2006 - Micros reports accounted for combined sales of \$263,549, while the CPA's worksheet reported sales of \$261,828, (a difference of \$1,721 underreported gross receipts to the County).
- December 2006 – Micros reports accounted for combined sales of \$348,541, while the CPA firm reported sales of \$348,580. There is a difference of \$39 in gross receipts over-reported to Parks.
- We also compared the Micros reports – *Consolidated System Menu Sales Item Sales Summary* and *Net Sales on the Monthly System Sales Summary* – for each of the months reviewed.
  - The *Consolidated System Menu Sales Item Sales Summary* did not agree with the *Net Sales on the Monthly System Sales Summary* in December 2006. Although the difference was only \$72, and the gross receipts reported to Parks did include this amount, we could not determine why these two reports did not agree. These two reports did agree for September 2006 through November 2006.

The underreporting of gross receipts resulted in underpayment to the County. For the period September 2006 through December 2006, the total net discrepancy between the consolidated monthly Micros sales report and the worksheet prepared by the CPA firm (used as the basis for the monthly reporting of gross sales to Parks), was \$12,015. Using the 11.75% fee rate applicable to the second half of 2006, Carlton underpaid the County \$1,412. Without the prior periods' reports, we cannot be assured that discrepancies such as these did not occur throughout the entire audit period.

Several times a year, Carlton offers a prix fixe menu buffet to the public, usually for holidays such as Thanksgiving, Mother's Day or Father's Day. The price includes the cost of the meal, a party service charge, and sales tax. Although the fixed price is entered into the Micros system in order to generate a receipt for the customer, the sales are manually reclassified from restaurant sales to catering sales, and broken out into three components.

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<sup>33</sup> For purposes of this reconciliation of the Micros reports, we did not include gift card sales or customer deposits because Carlton initially reports these as liabilities. When the gift certificates are redeemed or the customer affair is completed, the revenue is then recognized.

## **Audit Findings and Recommendations**

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We selected for testing one prix fixe menu event from 2005 (Father's Day) and 2006 (Mother's Day), and noted that the amount of sales recorded in the Micros report was higher than the sales reported in the bookkeeper's worksheet. For example, Micros restaurant sales reported on Father's Day were \$17,130, however, the bookkeeper reported only \$11,705 in restaurant sales, a difference of \$5,425. We found that Carlton had reclassified restaurant sales to catering sales, however the amount reported as catering sales of \$4,582, was \$843 less than the amount reclassified from restaurant sales. Consequently, Carlton underreported this revenue to the County. Similar reclassifications resulted in an underreporting of Mother's Day revenues of \$518. We were unable to obtain a satisfactory explanation for these reclassifications. Because of the numerous manual reclassifications made to sales consolidated in the Micros reports, there is the possibility that not all sales were reported to Parks and that, consequently, the fee paid to the County was underreported.

### **Audit Recommendations:**

Carlton should:

- a) on a monthly basis, provide to the County, a copy of the monthly Micros sales summary report and, reconcile and provide explanations for all amounts not reported to the County;
- b) ensure that all documentation, including backups of the Micros system, is retained in accordance with the retention requirements of the licensing agreements;
- c) document any reclassifications made for audit purposes; and
- d) remit the applicable fee for any revenues incorrectly excluded from the gross receipts reported to Parks including:
  - i. \$1,412 attributed to the differences noted between the Micros monthly sales report and the worksheet prepared by the CPA firm.

**Audit Finding (6):**

**Inadequacy of Record Retention and Records**

Carlton did not use pre-numbered contracts or invoices, was missing contracts, did not retain appointment logs of catered events and generally, had poor record retention. As a result, not all revenues may have been accurately reported to the County, resulting in an underpayment of fees to the County.

*Catered Events*

Customer deposits for catered events are primarily received by check, and final payment is typically made by cashier's check or cash. Final payments on the catered events are not usually recorded in the point-of-sale system (Micros). Consequently, there is no system log of these payments.

Customers who retain Carlton for private parties or catered affairs sign a contract which specifies the agreed upon menu and services to be provided. Customers must pay a deposit towards the invoiced amount upon contract signing; this deposit is recorded by Carlton as a customer deposit (liability) in its general ledger. When the event takes place and final payment is made, the final payment and the initial deposit amount are recorded as Catering Sales in the month that the event takes place.

Catering contracts and invoices are not pre-numbered and are not required for all events. In order to test the accuracy of the catering sales, we requested to review records, such as a catering log or appointment book, to determine if affairs reported on the logs could be traced to the sales records maintained by the bookkeeper and the CPA. The CPA managing partner informed us that such logs do not exist; and Carlton's management indicated that scheduling was done via an erasable white board in the office, which was continually updated, and therefore, we were informed that Carlton retained no appointment records of prior events.

We were provided with monthly Microsoft Excel schedules that listed catered events; the listing contained the name of the customer, the advance deposits and final payment, and an indication of whether or not the event was subject to sales tax. We reviewed a sample of invoices selected from the Microsoft Excel schedules prepared by Carlton each month and attempted to trace them back to original contract agreements.

During the testing, we noted that:

- neither the contracts nor the invoices were pre-numbered, therefore we could not be assured that all contracts were accounted for in the monthly Microsoft Excel schedule;
- Carlton did not appear to have signed contracts with customers for all catering affairs, as no contract was attached to some of the invoices provided to the auditors. The CPA firm confirmed that party agreements are not always in writing;
- some contracts and related invoices were missing from the binders provided to the auditors; and

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## Audit Findings and Recommendations

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- there were invoices where significantly lower per person costs were charged than the majority of invoices we reviewed. Furthermore, there were no contracts attached to these invoices in order to determine if the menu provided for those events seemed reasonable in comparison to the amount charged the customer; these events appeared to have been political fundraisers.

We further noted, in our test, that a \$1,500 invoice for one catered event in 2004 that did not have a contract attached, could not be traced to the Microsoft Excel schedule of catered events. As these Excel reports are used as a basis in determining the revenues reported to the County, we could not determine if all catering sales were reported to the County.

### *Record Retention*

In August 2006, Carlton upgraded the Micros system. During our audit, we requested monthly consolidated reports for the audit period; however, we were informed that they were not available for the period prior to September 2006. Consequently, our testing of the Micros monthly consolidated reports was restricted to September 2006 – December 2006.

Without the original documents, we could not be assured that all sales occurring during the audit period were correctly reported to Parks and that the correct fee was paid to the County.

### **Audit Recommendations:**

Carlton should:

- a) prenumber all catering contracts/invoices and the numerical sequence of each should be accounted for;
- b) ensure that all private affairs/catered events should be supported by a pre-numbered contract;
- c) all documentation should be retained for audit purposes;
- d) investigate whether deposits and the final payment for catered events may be processed through Micros for better control of the receipts; and
- e) establish a catering logbook that can be cross-referenced to pre-numbered catering event contracts, and retain the logbooks for audit purposes.

## Audit Findings and Recommendations

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### **Audit Finding (7):**

#### **Internal Controls Surrounding Sales**

As part of our review of the internal controls surrounding Carlton's sales of food and beverages, we noted that the wait staff initiated Voids, Cancel and Error Correct transactions in the Micros point-of-sale system. These transactions are significant; over the thirteen-day test period selected by the auditors, the following was noted:

- 307 voided transactions totaling \$8,955;
- 19 management voids totaling \$221;
- 834 error corrects totaling \$15,121; and
- 595 cancelled transactions totaling \$4,246.

Given the number of transactions in the 13-day period, we reviewed records for September 2006 through December 2006 and found that Carlton recorded 1,472 voids (\$57,258), 183 manager voids (\$2,042), 4,802 error corrects (\$102,312), and 4,217 cancels (\$97,715).

These transactions were processed without approvals or reconciliations of supporting documentation to total voids by the management, bookkeeper, or the CPA firm.

According to the CPA firm, these transactions occur for a number of reasons, including a change in or a problem with an order, an error made by the wait staff, and voiding the 18% to 20% fixed gratuity for large parties when the gratuity is paid in cash. If the wait staff is busy, they may not always include the supporting documentation, such as the register slips, that support the voids, cancellations or error correction transactions, and therefore, reconciliation is not possible.

We also noted that the Micros point-of-sale system has the ability to account for various discounts (e.g., employee and promotional discounts). However, complementary meals (i.e., meals that have been provided to patrons at no charge), were merely voided from the daily sales. Consequently, there is no method to account for the total number or value of complementary meals.

Based upon our review, we concluded that without management oversight of voided, cancelled, or corrected transactions:

- the internal controls surrounding these transactions are not sufficient to preclude or detect the misappropriation of funds collected at the restaurant;
- we could not be assured that transactions occurring at Carlton were accurately reflected as sales in the Micros point-of-sale system; and
- we could not be sure that the value of restaurant receipts were accurately reported to the County.

### **Audit Recommendations:**

Carlton should require that:

## Audit Findings and Recommendations

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- a) all voided or corrected sales receipts be signed by the manager in charge during the shift;
- b) the manager or accounting staff reconcile the voided or corrected transactions to supporting documentation approved by the shift manager; and
- c) a copy of all authorized voided or corrected sales receipts be retained for reconciliation and audit purposes.

### **Audit Finding (8):**

#### **Performance Bonds**

Both licensing agreements require that Carlton secure a performance bond as security to the County for any deficiency that may arise from any default on the part of Carlton. The performance bonds required under the two licensing agreements are:<sup>34</sup>

<u>1995 Agreement</u>		<u>2003 Agreement</u>	
<u>Years</u>	<u>Amount</u>	<u>Years</u>	<u>Amount</u>
1-5	\$ 250,000	1-5	\$ 90,000
6-10	350,000	6-10	120,000
11-15	400,000	11+	150,000
16-20	450,000		

In accordance with the above schedule, Carlton should have maintained performance bonds in the following amounts during the audit period:

	<u>1995 Agreement</u>	<u>2003 Agreement</u>
2004	\$350,000	\$90,000
2005	\$350,000	\$90,000
2006	\$400,000	\$90,000

During our fieldwork, Parks indicated that it had not received any evidence of the existence of performance bonds. We requested evidence of insurance from Carlton and were provided, as evidence of the performance bond under the 1995 Agreement, a “Continuation Certificate” from an insurance company for \$350,000. The term of the coverage was from September 21, 2006 through September 21, 2007 (year 12 of the licensing agreement). The amount of the performance bond should have been \$400,000. Parks indicated that no performance bond was in existence during the audit period prior to September 2006 and Carlton did not provide evidence of a performance bond under the 2003 Agreement.

In June 2008, Parks provided us with evidence that it had received proof of the existence of two performance bonds – one for \$400,000 (expiring in September 2008) and a second

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<sup>34</sup> § 39 of the 1995 Agreement and § 4.4 of the 2003 Agreement.

## **Audit Findings and Recommendations**

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one for \$120,000 (expiring in June 2009). A Change of Bond Rider was provided showing that the performance bond was increased in June 2008 from \$350,000 to the required \$400,000.

### **Audit Recommendations:**

Carlton should:

- a) comply with the terms of the licensing agreements and provide the County with the original performance bonds in the amounts required per the agreements; and
- b) obtain and retain evidence that the bonds were presented to the County.

### **Audit Finding (9):**

#### **Compliance with Other Insurance Requirements of Licensing Agreements**

Both licensing agreements require that Carlton obtain liability policies naming both Carlton and County as the insured. Section 38 of the 1995 Agreement requires that Carlton obtain a comprehensive public liability policy with a combined single limit of \$1 million for bodily injury, including personal injury and property damage, for any one occurrence. The liability policy should include coverage for Fire Legal Liability<sup>35</sup> with a property damage limit of \$250,000 per each occurrence and Liquor Liability<sup>36</sup> coverage with limits of \$1 million per occurrence. Section 25 of the 2003 agreement requires Carlton to obtain one or more policies for commercial general liability insurance and have a minimum single combined limit of liability of not less than \$5 million dollars per occurrence and \$10 million dollars aggregate coverage.

The 1995 Agreement also requires that Carlton secure full product liability insurance, including foreign objects, with limits of \$1 million per occurrence, and that it must also comply with all provisions of the Workers' Compensation Law. The 2003 Agreement also requires that Carlton obtain Workers' Compensation coverage in compliance with New York State Law and, at the County's request, additional insurance (such as "Contractor's Liability Insurance").

Carlton is required to furnish all certificates and/or copies of policies to the County. According to our discussions with key employees in Parks and the County Attorney's Office, neither County department had current evidence of Carlton's insurance coverage. We requested copies of the insurance certificates from Carlton, and were provided with copies for the five fiscal periods beginning February 23, 2003 and ending February 23, 2008, which included dates subsequent to the audit period. Each certificate listed Parks as the certificate holder and additional insured party. However, we noted several discrepancies with the certificates:

- Each of the certificates reviewed (from 2/23/03 to 2/23/08) had fire legal liability coverage listed on the certificate as "damage to rented premises"; however, the coverage was limited to \$100,000 per occurrence instead of the \$250,000 as required by the 1995 Agreement;
- Liquor Liability insurance required under the 1995 Agreement was not included in the 2/23/03 to 2/23/04 certificate;
- The 2003 Agreement required additional insurance coverage, however, this coverage was not included in the insurance certificates for the periods, 2003-2004, 2006-2007, and 2007-2008 (which was provided to us, although the policy period is subsequent to our audit period);

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<sup>35</sup> Coverage needed for leased or rented property as protection against legal liability due to fire or explosion at rented or leased premises.

<sup>36</sup> Protects the insured engaging in the manufacturing, distributing, selling or serving of alcoholic beverages, against liability imposed by law or statute for injury or damage resulting from actions because of intoxication of any other person due to the sale or distribution of alcoholic beverages by the insured.

## **Audit Findings and Recommendations**

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- The 2003-2004 certificate had no authorized representative signature for the insurer;
- The 2005-2006 certificate had a different start date for the Excess/Umbrella Liability coverage than the primary general liability insurance coverage and the prior year;
- The 2006-2007 certificate listed the policy number as TBA; and
- The 2007-2008 certificate had an additional insured party listed.

These discrepancies may expose the County to unnecessary and costly litigation and damage payments at Carlton.

### **Audit Recommendations:**

Carlton should:

- a) maintain insurance coverage that complies with the two licensing agreements and amendments; and
- b) provide evidence of the insurance coverage to the County on a timely basis, as required by the licensing agreements.

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## Audit Findings and Recommendations

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### **Audit Finding (10):**

#### **Compliance with Reporting Requirements**

During the audit period, Carlton did not adhere to the reporting requirements stated in the licensing agreements.

#### *Financial Statements*

Both licensing agreements require Carlton to provide annual financial statements to both Parks and the County Comptroller's Office.

- Section 28 of the 1995 Agreement states that a detailed profit and loss statement must be submitted to Parks and the County Comptroller's Office within ninety (90) days after the close of each contract year, the statement must be prepared by an independent Certified Public Accountant and include all food, and beverages operations at the licensed premises.
- Section 4.5 of the 2003 Agreement requires that financial statements be submitted to Parks on or before the thirtieth (30th) day following each operating year. The financial statements are to be signed and verified by a member of a "Certified Professional Accounting" firm or by the president or chief financial officer of Carlton.

Carlton's CPA firm compiles and reviews annual financial statements for Carlton. According to Parks, Carlton did not provide these documents to the County, although Carlton's management indicated that the financial statements were sent to the Deputy County Attorney assigned to Parks. We requested, and Carlton provided, the financial statements covering the audit period. However, the financial statements for the year ended December 31, 2006 were not available until after our fieldwork was completed in October 2007, clearly beyond the 90 and 30-day delivery dates stated in the licensing agreements

### **Audit Recommendations:**

Carlton should provide annual financial statements to Parks within the time period specified by the Agreements.

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**Exhibit I**

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**The Carlton  
Audit Period 2004-2006  
Audit Disallowances**

<b>Category</b>	<b>Audit Finding #</b>	<b>Total Disallowances</b>
Underreporting of Revenues to the County	1	\$ 386,872
Carlton Express	1	\$ 46,327
Unauthorized Deductions	2	\$ 11,015
Erroneous Computations	4	\$ 59,259
Discrepancies in Records	5	\$ 1,412
<b>Total Audit Disallowances</b>		<b>\$504,885</b>

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Revenues not quantified in this report:

Unreported Catered Events

Unreported Other Income from Intercompany Transactions

Note: This schedule is not an all-inclusive list of monies due the County, but merely a summary of those items that could be quantified, based upon Carlton revenues excluded from, or incorrectly calculated in, the monthly rent due the County. Unreported catered events and other income from intercompany transactions, could not be quantified.

**RESPONSES TO THE LIMITED  
REVIEW OF CARLTUN ON THE PARK, LTD'S  
COMPLIANCE WITH ITS NASSAU COUNTY  
LICENSE AGREEMENT**

**RESPONSES TO THE LIMITED REVIEW OF  
CARLTUN ON THE PARK, LTD's COMPLIANCE  
WITH ITS NASSAU COUNTY LICENSING AGREEMENT**

**PRELIMINARY STATEMENT**

Carlton on the Park hereby responds to the County of Nassau's report dated April 16, 2009.

Sometime in 2007, Carlton On The Park Ltd. (hereinafter "Carlton") was contacted by Lisa T. Tsikouras who informed Carlton's management that she was to undertake "an audit" of Carlton's records. In February, 2008, Carlton's accountants, Sklar Heyman & Company who responded to the County's audit teams' inquiries, was informed that the records provided to the County could be returned to storage.

After approximately **fourteen months**, Carlton received a letter dated April 16, 2009 together with a "draft report" of the County's findings. The County demanded a response in fourteen days (May 1, 2009).

Upon its request, Carlton was granted an additional three weeks to May 22, 2009, to respond to the draft report.

At great personal sacrifice and time, Carlton responds with this document and accompanying exhibits. There may be more to be said concerning the draft report but Carlton will withhold editorial comments.

On Tuesday, May 12, 2009, County Executive Suozzi addressed the members of the Family Court section of the Nassau County Bar Association at a luncheon held at Domus. During that wonderful, articulate and humorous presentation, he addressed the County's desire to implement a program which would, through "interoperability", cause various of the County's agencies to act in a more uniform manner in regard to social services to citizenry for education, health and safety.

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He in effect wanted the various agencies of the County delivering those services to know what the other was doing to streamline and provide services to citizens. In so many words, making certain that the right hand of government and the left hand were not duplicating effort or giving contradictory advice or direction.

Here, the Office of the Comptroller, in its audit, has not properly credited the actions of the County Attorney or the various Park Commissioners or the Deputy County Executive involved in Carlton matters who made commitments and with respect to Carlton. The Deputy County Executives under the County Charter are the next in the line of command to the County Executive who could make binding determinations on the County's behalf. We feel "interoperability" did not occur historically and amongst County personnel with respect to the audit. When reviewing this history, it is clear that when the left hand was doing something, the right hand was doing or saying something else.

### **Auditor's Follow-up Response**

*We audited Carlton's compliance with the contracts, as amended and approved by the County Legislature.*

## **BACKGROUND**

In 1994, the County put out an RFP on the Old Salisbury Inn to operate the facility by a private operator. The successful bidder was unable to raise financing and the bid was withdrawn and rebid in 1995.

The Carlton was the successful subsequent bidder on the Old Salisbury Inn and a lease/license was signed in July, 1995. At the time of the bid, the only section open was in the area that is now the

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Palm Court restaurant. The room was occupied by old fashion, dilapidated redwood picnic tables with seats attached and stainless food carts on wheels. The people using the facility generally brought their own lunch in brown bags and either purchased a drink or also brought a beverage.

The facility was a long-time eyesore that was in dilapidated condition with inoperable lights, toilets, sinks, windows, doors and hat check equipment. The facility was infested with vermin and really should not have operated.

After the expenditure of some five million dollars of its own capital, the main floor was complete and "soft" opened in December 1995. Over the next two years, the second floor was renovated creating "Havanas Cigar" Club and the basement renovated to create the Wine Cellar was created at a cost of another two million dollars.

The County has, as a result, The Carlton, the most beautiful building the County owns that is the envy of other local municipalities and the State of New York. The County went from no income from this building to where it probably has received 8 to 10 million in rent revenue over the term of occupancy.

Carlton management, with other parties, commenced other restaurant operations through other corporate entities, Franco and Gianni Catering in Bayville, New York, a long-time business of Anthony Capetola became Carlton on the Sound and then in succession in 1998, formed Carlton Hospitality of New Jersey to operate the Temple Bar in Caesar's Hotel & Casino in Atlantic City, New Jersey; Carlton Hospitality of Nevada which operated Olio, an Italian restaurant in the MGM Grand in Las Vegas, Nevada, and operated the catering at the Lloyd Neck Beach and Tennis Club for a short period of time. The tragedy of 9/11 aborted the development of other facilities in Washington, D.C., Florida and New Jersey.

In 2003, The Carlton was the successful bidder to operate the 19<sup>th</sup> Hole Restaurant in the last unfinished section of The Carlton building. The 2003 lease/license was to start in the summer of

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DRAFT - NOT INTENDED FOR EXTERNAL DISTRIBUTION \* CONTAINS NON-FINAL, INTRA-AGENCY AND/OR INTERAGENCY MATERIALS THAT MAY BE EXEMPT FROM DISCLOSURE UNDER THE FREEDOM OF INFORMATION LAW

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2003 with "zero percent of gross receipts and prorated portion of flat fee" as rent in 2003.<sup>37</sup>

Unfortunately, several other County contractual obligations not divulged in the 19<sup>th</sup> Hole RFP prevented operations or renovations from commencing. Specifically but briefly, the RFP did not divulge or have apparently been considered by the County, the following:

- 1) The men's locker room which was located in the area where the 19<sup>th</sup> Hole restaurant is now located, was filled with metal lockers, many of which were filled with the valuables of Nassau County citizens under some type of undisclosed occupancy or rental agreement. Since the premises was to be delivered vacant and broom clean, the County was confronted with the question of what was to happen to the occupied lockers and how to terminate the tenancies. A problem not previously adequately considered by the County.
- 2) That under a prior RFP, Dover Catering, Inc. (Butch Yamali) had a lease to continue a snack bar and vending machines in the area leased to Carlton under the 2003 RFP which were not disclosed or provided for the by the RFP and the County wanted him to continue his service in the entire Park.
- 3) The plans for the 19<sup>th</sup> Hole approved by the County with great architectural input from former Commissioner Doreen Banks were approved and after construction was underway, the County substantially delayed construction by refusing to provide 600 AMP service so that ultimately Carlton had to bring 600 amp service to the Building which was the responsibility of the County.

Notwithstanding the above and at an excessive additional expense to Carlton, the 19<sup>th</sup> Hole

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<sup>37</sup> Section IV Para. 4.1 of Lease dated June 11,2003.

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was opened at a cost in excess of 1.5 million dollars in construction costs.

After a series of conferences with Michael Klein, the Deputy County Executive in charge of Park's, correspondence was exchanged and the 19<sup>th</sup> Hole lease commenced August, 2004 with all percentage rent starting on the licensee's anniversary date in August, 2005.

### **Auditor's Follow-up Response**

*The 2003 Agreement, Section 4.1, calls for the monthly percentage rent payments to commence on February 18, 2004. The amendment to this Agreement did not change the start date for the rent based on a percentage of gross receipts. Instead, it changed the commencement of the flat fee portion from June 16, 2003 to August 1, 2004.*

On page ii of the audit, there was noted a significant drop in income of Carlton. The exact reason for this was a substantial increase in competition from new catering facilities in the County which were just opening or maturing in their operations as well as the continued renovation of other experienced catering facilities in Nassau County. These other operations also lowered their prices substantially which cut into the business of The Carlton.

The auditors note there was a significant drop in income between 2004 and 2005. The auditors state that they were unable to verify this since appointment books indicating utilization of the facilities were not provided. The auditors were provided with all financial statements, corporate tax returns, both federal and state, and sales tax returns for all periods covering the audit. These documents were exact copies of the filings made with both federal and state taxing authorities, as well as independent banking institutions who provided various credit facilities. The various tax documents were prepared in accordance with Federal and State tax laws in effect at the time of preparation. The financial statements were reviewed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accounts (as

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indicated in the Accountant's Review Report of each financial statement), which were in effect at the time of preparation. Carlton objects to the implication that these documents were prepared inaccurately and/or improperly.

### **Auditor's Follow-up Response**

*We asked to review catering appointment books as part of analytic testing. The appointment books would have been used to determine if there was a reasonable correlation between the drop in revenue and a drop in the number of events booked at Carlton. The appointment books would also have been used to make selections for cash receipts testing, to ensure that all events booked had both written contracts and recorded cash receipts. This would have helped provide assurance that the cash receipts from all events were included in Carlton's reported revenue to the County.*

In the background information on page ii, the auditor's note stated that Sklar, Heyman & Company had declined to give the auditors the audit report for a New York State Sales Tax audit. The New York State Sales Tax audit covered the years 1995 through 1998. Since the sales tax audit occurred out of the County's audit period, this information was inconsequential to the current audit. Notwithstanding, in fact, the Nassau County auditor for the period 1999 through 2001, Peter Graven, was provided the documentation for the New York State Sales Tax audit. Regardless, there was "zero" change in the returns for income items of The Carlton.

### **Auditor's Follow-up Response**

*The Comptroller's Office has no record of Carlton's audit by the State Department of Taxation and Finance. If Carlton provided a copy of the State audit to a former employee of this office, it could have provided a duplicate copy to our auditors in connection with the current audit.*

The County auditor also states that they could not determine the accuracy of the revenues reported to the State. Sklar, Heyman & Company LLP provided copies of all sales tax returns, as filed with New York State, and backup calculations for every month of the audit period. We strongly object to the implication that the sales tax returns are prepared inaccurately and/or improperly report revenues.

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DRAFT – NOT INTENDED FOR EXTERNAL DISTRIBUTION \* CONTAINS NON-FINAL, INTRA-AGENCY AND/OR INTERAGENCY MATERIALS THAT MAY BE EXEMPT FROM DISCLOSURE UNDER THE FREEDOM OF INFORMATION LAW

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### **Auditor's Follow-up Response**

*It is normal audit protocol to request copies of all audit reports issued to the auditee, these include those of independent accountants, regulatory agencies, and taxing authorities. We review these reports to determine if any issues raised were relevant to the audit. Our inability to perform tests of cash receipts using appointment books as a source for sample selection, combined with Carlton's unwillingness to share the results of audits performed by New York State, impaired our ability to determine the accuracy of revenues reported to the County.*

Another comment on page ii was that Carlton agreed to open an interest bearing account (a repair and refurbishment account) to be used for future repairs of the 19<sup>th</sup> Hole under the 2003 lease. Mr. Capetola spoke to County Attorney Nicholas Thalasinis many times about opening that account and wrote to him by letters dated August 10, 2004, November 10, 2005 (all annexed as Exhibit A). Mr. Capetola also met with John Macari an official of the County. Mr. Capetola forwarded signature cards to Mr. Thalasinis to open the account without response from the County.

Ultimately in a conference call with Mr. Thalasinis and a representative of the Comptroller's Office in early 2006, Mr. Capetola was informed that the County would not open a joint account with a private entity and a new solution had to be had.

Thereafter, and again, after repeated informal talks with Mr. Thalasinis, The Carlton made its own repairs because **The County** would not join in opening that account.

### **Auditor's Follow-up Response**

*The agreement should be amended to delete the requirement of a joint account since the Treasurer's Office has advised us that they will not approve a joint account. The Comptroller's Office was not involved in any discussions regarding the opening of this account.*

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So we ask rhetorically, if the County breaches the 19th Hole Agreement by refusing to sign bank signature cards should the requisite repairs have gone undone, i.e. would this have been the pragmatic approach? The Carlton did just that, and the 19th Hole section is in pristine condition with everything fully operable. Of course, we could have still been waiting for such condition precedent to be met and which would have rendered the 19th Hole partially inoperable to date.

On page iii, there is a statement that the CPA firm prepares a monthly revenue analysis. At no time did the CPA firm advise the auditors that they prepare a monthly revenue analysis. The auditors were advised that the CPA compiles the information from the books and records provided by Carlton necessary for the preparation of sales tax returns.

### **Auditor's Follow-up Response**

*The report provided to us by the CPA did not contain a title. We referred to it as an analysis because in addition to compiling information, it includes reclassifications made by the CPA. This analysis is the basis for the revenues reported to the County.*

**RESPONSE TO THE ERRONEOUS CONCLUSION OF  
UNREPORTED REVENUES DUE TO NASSAU COUNTY**

Carlton on the Park has strictly adhered to the reporting requirements for gross receipts reported to Nassau County. Based on the 2003 agreement, and as cited on page 1 of this audit report, Carlton has not included taxes required to be collected and paid against sales; tips; gratuities or other charges for services included in the account or bill of a patron and for which Carlton made actual payments to "employees or **others**" (emphasis added); and for monies refunded for cancelled events.

Mr. Capetola has timely submitted the annual financial statements to the County, as required by the licensing agreements, via delivery to Nicholas Thalasinis, the Deputy County Attorney. When the auditors indicated the financial statements were not properly submitted, Sklar, Heyman provided the auditor Mr. Thalasinis' name as the contact to whom the financial statements were timely submitted.

All financial statements, surety bonds and monthly revenue statements have been submitted to the County by Carlton since July 1995 the inception date of the original lease/license to date.

**Auditor's Follow-up Response**

*We were informed by both Parks and the County Attorney's Office that the financial statements and current evidence of insurance were not provided by Carlton. Parks informed us that it had not received evidence of a performance bond.*

Carlton has been confounded in its desire to have an ongoing dialogue with the County because of the internal changes in County personnel from John Kiernan to Kevin Ocker to Vincent Neglia to Doreen Banks to Michael Klein to Dan Ayres to Peter Gerbasi to Richard Murphy during the periods pertinent to this audit. Our subsequent communication with Commissioner Lopez had not been eventful nor are they germane to the audit years involved.

Most importantly during 2004-2005, Michael Klein was a Deputy County Executive who

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under the county Charter had the authority to act as County Executive with regard to matters involving the audit period and had full authority to make determinations and directions binding the County.

### **Auditor's Follow-up Response**

*We audited Carlton's compliance with the contracts, as amended and as approved by the County Legislature. .*

Sklar, Heyman has reviewed the information included in Table One regarding financial statement income and revenues reported to the County. The amounts also are directly correlated to and tie out the schedules of revenues *reported by Carlton to the County*.

### **Auditor's Follow-up Response**

*We compared the revenues as reported in Carlton's financial statements to the revenues reported to Parks. Carlton's financial statements show \$4,613,186 more in revenue than was reported to Parks (see Table 1 of the audit report).*

Sklar, Heyman submitted to the auditors a schedule of party service charges. These charges were broken down by month, were reconciled to the general ledger and totaled \$3,341,860 for the three years under audit. There was an additional \$261,574 in party service charges for non-taxable parties for the three years under audit. **All** of the party service charges were paid to staff, management or other, as tips or wages as agreed to under the 1995 agreement and provided for under the 2003 agreement.

### **Auditor's Follow-up Response**

*The 1995 agreement does not permit any exclusion of revenues from the operation of the restaurant, cafeteria, bars vending machines, special meals revenues, and affairs. The 2003 Agreement states that gross receipts excludes taxes required to be collected and paid against sales: "(ii) tips, gratuities or other charges for services included in the account or bill of a patron and for which Carlton made actual payment. . ."*<sup>38</sup>

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<sup>38</sup> 2003 Agreement § 2.1 (m).

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*We were not provided with proof that all party service charges were paid out to employees. When we requested a reconciliation to substantiate the distribution to employees, the CPA firm responded in writing that there was no way to reconcile or show how the service charges were allocated.*

Because the management of Carlton had other restaurant business in other states and under separate corporate ownership, it made the determination to lease employees from a related company in order to permit the assigned leased employees to work for the various companies as it saw fit; and deemed necessary for the proper function of these entities, security personnel, chefs, managers, sommeliers and executives were frequently assigned to work in several different jurisdictions in the same week or month; leased bookkeepers worked for several companies in the same week with shared expense; basically The Carlton was a part of a much larger network of restaurants and catering facilities in three different states and five different locations.

When The Carlton was opened, it had one broken down cafeteria style restaurant facility and the original 1995 RFP did not adequately consider the fact that the finished product would have 12 different dining rooms and on occasion have as many as eight separate private functions going on as well as ala carte dining occurring simultaneously.

On busy days, there could be functions starting as early as 11 A.M., ending at 3 P.M., simultaneously with others at 2-6 P.M., and still others 7 P.M. to 1 A.M. Accordingly, waiters and busboys servicing these functions could service as many as five functions on a given day and twenty in a week.

New York state seeks to tax as much as possible. Because of New York State's policy of requiring the invoice for a function to identify the person receiving the gratuity to be exempt from sales tax, in facilities such as The Carlton, that is impossible because servers may work a percentage of time in five or more functions simultaneously. Rather than create fictitious assignments of the gratuity to comply with the law, Carlton simply pays the tax on all gross receipts and gratuities while

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still distributing all gratuities to its own or leased employees. Caterers are presented with a "Hobson's Choice" in this regard, either concoct invoices and assign names randomly or pay the full requisite tax as required by New York State law. Management has always taken the "high road" in this regard and paid the taxes and then as well, distribute the gratuity to the employees.

The Carlton therefore, for **SALES TAX PURPOSES**, cannot give an invoice to a customer with the name of the individual server on it. It's a bookkeeping impossibility, the cost of which would make the business impossible to run. The Carlton, in order to comply with this onerous requirement, would have to guess, approximate *or fabricate fictitious receipts*.

### **Auditor's Follow-up Response**

*We disagree with Carlton's response. The service charge billed to customers is not taxable, as a receipt from the sale of food or drink, as long as: "(1) the charge is separately stated on the bill or invoice given to the customer; (2) the charge is specifically designated as a gratuity; and (3) all such monies received are paid over in total to employees." (20 NYCRR 527.8[1]). No server names must be stated.*

Carlton's lease is different and permits Carlton to exclude from revenue, the "tips or service charges added to a bill "for which Carlton made actual payments to **employees or others**" (emphasis provided).

### **Auditor's Follow-up Response**

*Only the 2003 Agreement permits this exclusion. The 1995 Agreement does not permit it. We requested that Carlton provide a reconciliation of service charges received to service charges paid out to employees. The CPA firm responded in writing that there was no way to reconcile or show how the service charges were allocated.*

The auditors gave credit for \$1,098,904 of tips paid by Carlton, outside of payroll checks for the three audit years, and separately stated in the general ledgers of the company. However, the auditors did not take into account **all** tips paid, and reported on the employees W-2's as tips in box 7.

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The tips paid during the audit period, per the W-2's and W-3's reported to the IRS, Social Security Administration and New York State, for the audit period totaled \$2,297,927. These amounts can be broken down by year as follows: 2004-\$832,662; 2005 - \$772,290; and 2006 - \$692,975. The company's total wage reports showing the above amounts can be provided upon request. The amounts above the \$1,098,904 credit given, \$1,199,023 (\$2,297,927 minus \$1,098,904) were paid to employees in their weekly paycheck. As a result, these amounts were included in payroll on the general ledger, rather than being broken out and posted to the separate general ledger tip account. Copies of our W-2's and W-3's for 2004, 2005 and 2006 are annexed as Exhibit "B".

Of the total party service charges collected, \$167,698 was attributable to parties held in the clubhouse from the period July 2004 to June 2005. As there was no percentage rent factor to be applied during this first year of operation, these party service charges should be removed from any calculation of rent as more fully discussed and explained further herein.

Pursuant to an agreement dated May 13, 2002, any party service charges collected in excess of payments paid to Carlton's own employees shall be paid to Bayville Hospitality to be given to its leased employees. Bayville is then responsible for paying its employees the agreed upon wages, benefits and tips. During the audit period, there were payments made by Carlton on The Park to Bayville Hospitality, for leased employees and related expenses, totaling in excess of \$3,700,000.00. The funds transferred include the balance of all party service charges collected and not paid as tips to employees of Carlton on the Park, as documented in the aforementioned agreement.

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### **Auditor's Follow-up Response**

*We asked for, but were never provided with, a reconciliation of the party service charges collected and party service charges distributed to employees and others. In addition to the \$3,603,434 Carlton collected as party service charges, other sources of tips would have included tips paid by restaurant patrons on charge cards as well as cash gratuities given directly to the staff. Without a full reconciliation of party service charges received and paid out, we cannot be assured that they were retained as revenue by Carlton.*

*Carlton's agreement with Bayville Hospitality is not relevant to its reporting of revenues to the County.*

The auditors found that the Carlton did not report to the County \$1,172,971 in gross receipts earned at the Gatsby/Clubhouse facilities for the period August 2004 to July 2005. The original agreement dated June 2003 called for the license term to begin in June 2003. Additionally, this agreement called for zero percent on gross receipts for the first year of the agreement. Unfortunately, the County was unable to hand over the facilities to Carlton at the agreed upon time. The lockers remained occupied and the County determined that they would cause more problems and incur more costs by trying to remove the occupants from their lockers prematurely. The County decided to not renew the locker agreements and eventually turned over to Carlton in the spring of 2004 so that Carlton was able to do renovations and open in July 2004. When Carlton opened the facilities in July 2004, they followed the terms of the agreement and did not pay percentage rent for the first year of the agreement. Carlton made the \$5,000 monthly flat fee payment during the first year of occupation of the premises, pursuant to the agreement.

### **Auditor's Follow-up Response**

*Under the terms of the Amended 2003 Agreement, Carlton was to begin paying the flat fee portion of the rent in August 2004. Carlton did not make this August payment until January 2008, after our notification to Parks that the payment had not been made. In addition, Carlton has not paid \$60,000 in rent covering May 2006 to October 2006, comprising \$30,000 under the 1995 Agreement and \$30,000 under the 2003 Agreement.*

Should the County desire, it can randomly check the pay stubs of our employees who are

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servers and it will see that those tips tie out exactly with amounts reported to the IRS. Sample pay stubs for 2005, 2005 and 2006 are annexed for illustration (see Exhibit "C").

### **Auditor's Follow-up Response**

*Our concern is with the possibility that Carlton has under-reported revenue to Nassau County by retaining all or a portion of the party service charges instead of paying them to employees.*

Carlton only acted as an escrow agent for the collections of taxes, tip and gratuities for the third party beneficiaries, the State of New York and its employees.

There has **never**, repeat **never** been an allegation to the State Department of Labor that any employee was not paid his tip or gratuity in the entire history of Carlton.

Pursuant to agreement with the original County Parks Commissioner, John Kiernan, tips were deductible from revenues just as taxes. Tips with respect to leased employees would be the definition of "**others**" in the phrase language of the 2003 agreement.

Peter Graven, the County auditor who audited Carlton's records for 1999, 2000 and 2001 and found no reason for audit change and concurred that Carlton was properly excluding tips under is original 1995 agreement as they were not Carlton's revenues but those of the employees.

Pragmatically, how else can Carlton operate? The vast majority of our customer invoices are paid by check or credit card to The Carlton. How can a waiter, busboy or maitre'd ask for a separate credit card or check?

A copy of the May 13, 2002 agreement was forwarded to Peter Graven of your office during the audit period and he informed our accountants that with respect to leased employees and regular employees, our procedures were correct and no rent was due on such gratuity.

In fact, at a chance meeting by Anthony A. Capetola with Mr. Graven in Mineola, his conversation with Mr. Capetola indicated that Mr. Graven never saw such pristine records and that gratuities and tips were properly recorded.

### **Auditor's Follow-up Response**

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*The agreements between the County and Carlton require that Carlton pay the County a percentage of its revenue; revenue includes the portion of the party service charges not turned over to employees. Carlton was not able to provide any evidence to show what portion, if any, of the party service charge was paid to its employees. Therefore, the entire party service charge should have been included in the calculation of Carlton's revenue under the two agreements.*

*Statements attributed to a former employee of the Comptroller's Office concerning Carlton's activities in 1999-2001 are not relevant to whether Carlton has accurately reported its revenue and paid the County what it is owed under the agreements. This audit report covers Carlton's contract compliance for 2004, 2005 and 2006.*

Finally, at the outset of the 1995 agreement, the County through and including the date of your audit, April 16, 2009, always took the position that all tips and gratuities were not includable in the revenues upon which report is based.

### **Auditor's Follow-up Response**

*We audited Carlton's compliance with the contracts, as amended and as approved by the County Legislature.*

During 2003-2004, a change took place in the management of Parks from Doreen Banks to Michael Klein. Banks, a County Commissioner, was replaced with a Deputy County Executive, Michael Klein.

During 2003 as stated above, the County could not deliver the 19<sup>th</sup> Hole premises because of it being occupied by the County's citizenry. Inasmuch as the County Attorney could not get the place vacated and Carlton's forces could not enter the premises until Spring 2004.

At this point, Deputy County Executive Klein had arranged for the Senior's Golf Tour to come to Eisenhower Park and in essence (not to have egg on the collective faces of the administration), took a hands on approach to get the Park ready for this national event.

Ultimately, there became many people involved in 2004, including golf course managers, Nick Thalasinis, Mike Klein and Anthony Cancellieri, amongst others.

Ultimately, the lease start date was amended to August 1, 2004 as stated above.

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### Auditor's Follow-up Response

*The lease start date was not amended – the amendment was to the start date of flat fee payments: “The flat fee portion of the license Fee payable by the CONTRACTOR to the COUNTY under the amended agreement shall commence on August 1, 2004 in the amount provided in the original agreement.”*

Percentage rent commencement however on the 19<sup>th</sup> Hole was postponed until August 1, 2005 due to various problems, including but not limited to conflicts with the lease of Dover Catering/Butch Yamali and the County; the County approved a set of plans for the 19<sup>th</sup> Hole which called for 600 amp electrical service to the 19<sup>th</sup> Hole (approved by Doreen Banks and Thalasinis), however, after Doreen Banks left the Eisenhower Park, Building Department staff and electricians would not bring that 600 amp service to the building. In an effort to make the building "Tournament Ready", and since the County could not afford to bring the 600 amp service in, The Carlton, relying on the County's promises to be reimbursed or made whole, at a cost of some \$80,000, provided this service at its own cost.

Deputy Executive Klein authorized the amendment to the lease/license that was executed by Carlton and the County. In three separate correspondences dealing with this issue (addressed to the Deputy County Executive dated August 10, 2004, August 17, 2004 and November 16, 2004, annexed as Exhibit "D"), it was agreed that only base rent would not start in August 2004 and that Carlton would get a rent credit because of the Yamali/Dover situation and the County not providing the electrical service.

We would be happy in any administrative proceeding to subpoena Mike Klein and the others named in this response to prove out our claims in this regard. Obviously, anything beyond an administrative review would require subpoenas to all commissioners, deputy county executives and other employees.

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### **Auditor's Follow-up Response**

*The lease start date was not amended Exhibit D, comprised of three letters provided by Carlton, does not evidence the County's approval for rent deductions. We requested that the County Attorney's Office and the Parks Department review their files for any documentation supporting Carlton's assertion regarding these rent reductions; we were advised that no documentation was found. We audited Carlton's compliance with the written agreements as approved by the Legislature.*

### **VALET CHARGES**

At the time of the 1995 bid, the County Attorney who prepared the bid used a model from used in one of the Town of Hempstead catering facilities and tried to cut and paste the bid to fit the Salisbury Inn. Upon the second bid (the original unfulfilled one was in 1994) in 1995 a bid meeting occurred.

Then Commissioner John Kiernan and Deputy Commissioner Kevin Ocker addressed the valet issue in a meeting at their office. Carlton management pointed out that the methodology of valet service set forth in the bid was unworkable because it was set up for only one catering function without regard to the fact that the restaurant was operating while multiple catering functions were occurring simultaneously.

With multiple functions occurring, some hosts would choose to have and pay for valet parking, others would not. Ala Carte dining (as required by the bid) presented another problem in that no one goes to a Long Island restaurant and has a separate bill for parking. It was agreed that Carlton could collect the fees for outside parking services and distribute them to the parking service, without such charges being considered revenue.

### **Auditor's Follow-up Response**

*There is no language in the agreements excluding valet parking fees from income and Carlton has pointed to none. We requested that the County Attorney's Office and the Parks Department review their files for any documentation supporting Carlton's assertion that the County agreed that valet charges would not be considered revenues; we were advised that no documentation was found.*

Through 1995 to 1999, this was simply attempted to be rectified *vis-a-vis-a* segregated

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account to pay for valet was to be established.

That proved unworkable and Carlton Express was formed at the end of 1999 with full knowledge and consent to the County to end the bookkeeping nightmare of trying to segregate the funds for each party. Further, the County Attorney was concerned about the County's liability by The Carlton for the acts of the employees of the valet company who were hired directly by Carlton for damage to cars parked, and personal injury/negligence lawsuits and encouraged this separate corporate structure as an insulation to the County from potential negligence of the valet parkers.

Although in the making for several years, Carlton Express was formed to allay the County's liability fears to some extent and to provide an orderly method to collect fees from those who opted to pay for valet parking for their guests of their functions, as well as ala carte patrons.

### **Auditor's Follow-up Response**

*We audited Carlton's compliance with the contracts, as amended and as approved by the County Legislature.*

*Our review of sample contracts contradicts Carlton's statement that ". . .some hosts would choose to have and pay for valet parking, others would not. . . ." Carlton's customer contracts state "Valet Parking @ \$125 per Valet . . .One Valet per Forty (40) Guests Mandatory". . . We are unsure as to why the subsequent distribution of the funds to Carlton Express would represent "a bookkeeping nightmare". The distribution of valet charges should be similar to the distribution of party service charges, which Carlton already does; both are separately stated on the customer's invoice.*

*Liability concerns are dealt with in the agreements by requiring Carlton to obtain insurance. Both licensing agreements require that Carlton obtain liability policies naming both Carlton and County as the insured. Section 38 of the 1995 Agreement requires that Carlton obtain a comprehensive public liability policy with a combined single limit of \$1 million for bodily injury, including personal injury and property damage, for any one occurrence. The liability policy must also include coverage for a property damage limit of \$250,000 per each occurrence and Liquor Liability coverage with limits of \$1 million per occurrence.*

Administrative fees paid to Carlton on the Park by Carlton Express were for reimbursement of administrative services and office expenses, paid for and provided by the staff of Carlton on the Park. These services include the keeping of the books and records, supervision of activities and problem resolution for Carlton Express by Carlton on the Park management. Additionally, there were

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various office supplies used in the administration and record keeping processes which were paid for by Carlton on the Park. Rather than specifically identify the various costs involved, management allocated an amount for these services and supplies.

### **Auditor's Follow-up Response:**

*The argument that the fees were expense reimbursement is not sound. With the exception of net profit – all revenues represent a reimbursement of expenses. Also, the 2003 contract specifically states that commission income is includable in revenues.*

We disagree with the assertion stated in the auditor's report that the intent of the original agreement between Carlton and the County was to include valet parking revenues as part of the reportable income to the County. The reason a separate valet company, Carlton Express was established was specifically done with the understanding that the valet revenues collected were not to be reportable as income to the County.

### **Auditor's Follow-up Response**

*The agreements do not exclude valet parking fees from the income reportable to the County.*

An outside, unrelated entity, Parking Systems provides the valet service to Carlton Express. Customers are directed to cut checks directly Carlton Express which, in turn, pays Parking Systems for their services. On occasion, customers erroneously make their payments to The Carlton or include the valet portion of their bill with the balance due for the party. In such instances, "The Carlton" remits the funds to Carlton Express.

### **ANALYSIS OF VALET CHARGES RECEIVED & PAID**

	<b><u>Carlton Express Gross Receipts</u></b>	<b><u>Carlton Express Valet Expense</u></b>	<b><u>Carlton on the Park Valet Expense</u></b>
2004	\$119,560.00	\$ 97,000.00	\$ 34,487.00
2005	126,455.00	103,900.00	52,156.00
2006	158,591.00	135,298.00	137,619.00
<b>TOTAL</b>	<b>\$404,606.00</b>	<b>\$336,198.00</b>	<b>\$137,619.00</b>

The above table shows the gross income derived from valet services provided for various

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catered events during the audit period was \$404,606.00. The above table also shows the expense paid for both Carlton Express and Carlton on the Park for valet services during the audit period was \$473,817.00. The extra expense is attributable to the Carlton bearing the cost of valet service, to serve restaurant patrons regardless of whether a private function is occurring during the restaurant's operating hours.

Based on the foregoing, the revenues derived from providing valet services should not be included in the gross revenues reported to the County when computing the fee in accordance with the agreements.

### **Auditor's Follow-up Response**

*We reiterate our findings and recommendations related to the reporting of valet parking revenues.*

## **FORFEITED DEPOSITS**

Contracts state that Carlton collects a non-refundable deposit upon signing a contract with a customer for a catered event. At times, customers need to cancel their event. In these cases, Carlton works with the customer to reschedule the event if practical and/or possible. In instances where rescheduling an event is not possible, Carlton will try to book that day with another party or event. When Carlton is able to do this, they will refund the deposit to their customer provided that Carlton doesn't incur a loss due to the cancellation. When Carlton is unable to book a new event, they will keep deposit amounts to offset any costs incurred due to the cancellation of the event. As such, the forfeited deposits are not deemed to be revenue but rather a reduction of costs incurred due to cancellation by customer.

### **Auditor's Follow-up Response**

*The 2003 Agreement specifically states that gross receipts should not include "monies actually refunded for cancelled events."<sup>39</sup> Consequently, deposits that are not refunded should have been reported to the County and the corresponding fee related to those earnings should have been*

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<sup>39</sup> 2003 Agreement, Section 2.1(m).

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remitted to the County. The 1995 Agreement does not exclude any earnings from reportable gross receipts.

*When a customer cancels an event, it would seem that actual costs would be minimal. What may be lost is the opportunity for the gross margin Carlton would have earned on the event. Carlton states that, "forfeited deposits are not deemed to be revenue but rather a reduction of costs incurred due to cancellation by customer"; however, its financial statements show that the forfeited deposits were recorded as revenue.*

### **GIFT CARDS**

There was a journal entry of \$86,978.00 made to adjust the gift card liability account to its proper balance t [sic] December 31, 2006. Although there was a journal entry to an income account, the entry was **not made** as a result of revenues received. The company had found that a bartender had misappropriated a great number of gift cards. Management reviewed those cards determined to have been fraudulently issued and cancelled them. As a result of the cancellations, the outstanding liability as of December 31, 2006 was overstated and therefore, necessitated an adjustment of the liability.

There were no revenues received and therefore, none reported.

#### **Auditor's Follow-up Response**

*Carlton recorded the reduction of gift card liability as revenue in its financial records. Carlton's explanation does not make sense. The normal journal entry for a gift card sale would be to debit cash and credit the liability. If the gift cards were stolen, and a liability had been recorded, Carlton would have to have recorded a loss from theft because no cash was received. As such, the cancellation of the cards would have been recorded as reversal of the loss from theft and reduction of the liability.*

*Carlton's CPA firm provided a more rational explanation in an October 16, 2007 e-mail by stating that Other Income – Gift Certificates was derived from an adjustment of the gift certificate liability to the proper balance as of December 31, 2006. It stated that only those gift certificates sold and not redeemed by December 31, 2006 were left open at December 31, 2006. Gift certificates that will not be redeemed represent revenue and should be reported to the County.*

### **VENDOR & COMMISSION INCOME**

The Commission income issue was discussed, *ad nauseam*, with prior County

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Commissioners and accountants.

All Carlton financial records were demanded by the County on December 26, 2001 (yes, the day after Christmas!) by Salim Ejaz, CPA and field auditors by letter bearing that date (see Exhibit "E").

### **Auditor's Follow-up Response**

*It is currently the Comptroller's Office's policy to agree to reasonable adjournments of time to respond to information requests. The information request made in 2001 by a former employee was for a copy of a previously prepared reconciliation of Gross Sales to Sales tax revenues— not all financial records.*

All records were made available virtually immediately and by October 8, 2002, the audit team concluded that there was no change required in any tax year from 1999 to 2001.

### **Auditor's Follow-up Response**

*The Comptroller's Office did not complete its audit of Carlton in 2001 beyond performing preliminary audit work. No conclusions were reached and no audit report was written. This audit began with the Entrance Conference held on May 16, 2007. It relied on information provided by the CPA firm and Carlton management after that date.*

Included in the file provided to Salim Ejaz were inter-office memos regarding commission income and vendor income. The County Attorney, who I believe was Judge Samenga and Department of Parks, concluded that all prior representations under the 1995 Agreement by the County in inducing Carlton's bid clearly stated that commissions and vendor income were not "sales" as contemplated by the 1995 agreement.

### **Auditor's Follow-up Response**

*We audited Carlton's compliance with the contracts, as amended and as approved by the County Legislature. The definition of Gross revenue, as per the contract, "includes all monies from the operation of the cafeteria, bars, vending machines, restaurants etc., and special feedings and affairs conducted on the grounds of the designated areas."<sup>40</sup> Commissions are derived from the operation of the facilities.*

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<sup>40</sup> 1995 Agreement Section 49.

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*We requested that the County Attorney's Office and the Parks Department review their files for any documentation supporting Carlton's assertion regarding commission and vendor income; we were advised that no documentation was found.*

As displayed by your chart, the \$109,759.00 received in 2004 was under the 1995 agreement was not rent and not yet due under the 2003 agreement.

### **Auditor's Follow-up Response**

*The \$109,759 Carlton received in 2004 was recorded in Carlton's financial records as Commission Income.*

Under the table setting forth the income of \$45,218 for January, 2006 - July, 2006, it is impossible to figure out whether those commissions were under the 1995 agreement or the 2003 agreement under which may be due at 5% on said amount not the 11.50% utilized.

### **Auditor's Follow-up Response**

*According to Carlton, commission income was derived from Carlton's preferred vendors (such as, photographers, florists, music providers) that are primarily associated with catering. Carlton reported approximately 90% of its catering sales as being generated under the 1995 agreement.*

With respect to your calculation as to vendor income, we totally disagree with your analysis and again believe there is no basis for these claims. At this time, we believe that some constitute part of the commission income recorded in your table on page 10 of the audit report. Without further information, we believe the County double counted, i.e. said amounts specified were included and totaled in two separate categories. All if not some portion may be applicable to the 2003 agreement at the lesser percentage of 5% rather than the 11.75% applied.

### **Auditor's Follow-up Response**

*The vendor income and commission income, as presented in the Table in our audit report, were obtained from Carlton's general ledger, and reconciled to its financial statements. These amounts are not double counted, as they are a component of the total revenues not reported to*

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*Parks, as shown in Table 2. Carlton's response does not address why it did not pay the County a portion of the commission income earned under the 2003 Agreement.*

### **OTHER INCOME**

Although the amount stated to be due the County is only \$1,115, we disagree with the County analysis with regard to this amount. Nor can we tell from the draft whether it was calculated under the 1995 or 2003 agreement.

### **Auditor's Follow-up Response**

*The other income was derived from room rentals, tobacco, and miscellaneous sales. Because Carlton is obligated to pay different percentages of gross revenue under the 1995 Agreement and the 2003 Agreement, its records must be kept in a manner that allows for this identification. Carlton should be able to determine the exact breakout from its own records. Carlton gives no basis for its disagreement.*

### **CONCLUSION**

There is substantial dispute to the County's interpretation of its agreement with The Carlton and based upon the foregoing information provided, the County should exclude virtually all charges dealing with categorization of income.

### **Auditor's Follow-up Response**

*We reiterate all audit findings and recommendations as presented in our audit report.*

**CARLTUNS RESPONSE TO DEDUCTIONS MONTHLY  
FEE PAYMENT AMOUNTS BY THE AUDIT**

1. Carlton's deduction from rent of \$6,735.00 on December 16, 2009 was not only justified but approved by Commissioner Murphy.

Under both the 1995 and 2003 lease/license agreement, the County is obligated to bring power to the building and thereafter Carlton is responsible for service within the building.

At least 10-12 times per year since the inception of operations, power to the Carlton goes off because of the antiquated, outdated and poorly kept power lines to the building. Service for Carlton on the south side from lines maintained by Parks from Hempstead Turnpike and on the north side maintained by Parks from Old Country Road. Although the County has upgraded service for the new swimming pool area and other County Buildings, nothing has been upgraded for Carlton. On December 16, 2005, power was lost on the entire south side of the building, no lights, elevator, cooking facilities were operable. At that time, a Christmas Party that was ongoing by Manchester Publishing had to stop and we lost all ala carte dining in Palm Court because of the exceedingly low temperatures. Our building was freezing and not habitable for 48 hours causing substantial loss in income to Carlton.

The County's failure, due to lack of maintenance to the lines servicing Carlton, amounted to recklessness and could have caused even more damage had it not been for Carlton's actions.

Rather than seek to litigate a claim that over the years which cost Carlton hundreds of thousand of dollars, Commissioner Murphy authorized the deduction directly to Mr. Capetola inasmuch as the County did not "maintain and upgrade and abide by its obligation to utility facilities .....with reasonable.....efficiency.....County shall not be responsible resulting from causes beyond **its own control**..... Here, the County was directly responsible as the loss of power was totally in its control and it failed to meet its ongoing maintenance obligations.

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Through December 2005 and January 2006, this issue was negotiated over at least a dozen conversations with Commissioner Murphy. The Commissioner, in fact, directed that the deductions from rent take place exactly as set forth in the audit report, in two separate deductions. A January 9, 2006 and January 20, 2006 letter to Commissioner Murphy submitted to the County on that date is annexed hereto as Exhibit "F".

### **Auditor's Follow-up Response**

*We audited Carlton's compliance with the contracts, as amended and as approved by the County Legislature.*

*The January 9 and 20, 2006 letters referenced as Exhibit "F" are unsigned. Carlton did not provide any evidence that the Commissioner responded and that the County accepted the disallowance. In a September 25, 2007 correspondence from Parks, a Deputy County Attorney wrote "Both the \$3,516.81 and the \$3,218.63 deductions should be disallowed. Neither of these deductions was approved by the County: the 1995 Agreement clearly provides that the County is not responsible for these costs." In a January 3, 2008 letter to Carlton, the County Attorney wrote that Carlton retained liability for these items.*

2. Carlton's deduction from rent of \$2,250 was authorized by Nicholas Thalasinis, County Attorney, Anthony Cancellieri, Chief Deputy County Executive, and Don Ayres.

In 2005, the County wished to upgrade the men's locker room below Carlton, specifically upgrading the showers, sinks, toilets, floors and walls and electric.

Inasmuch as Carlton was familiar with the building and because emergency renovations for the job were exorbitant, Carlton undertook the renovation and was given a rent credit.

Items such as soap dishes, mirrors, bathroom partitions between commodes were amongst the things the County would provide through its own forces and not included in Carlton's obligations.

On the eve of the 2005 tournament, the County did not complete its own work. Toilet bowls were installed by Carlton but there were no privacy partitions installed between them by the County.

A frantic Don Ayres, the then County designate in charge of the Senior tournament issues asked if Carlton could get it done expeditiously and we answered the County's request to install the

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partitions on the County's property. Anthony Capetola spoke directly with Deputy County Executive Anthony Cancellieri, Don Ayres and Deputy County Attorney Thalasinis with regard to executing Mr. Ayres' request.

All of this was memorialized, in part, in a letter to the County dated June 21, 2005 addressed to Commissioner Murphy (a copy of that letter is annexed as Exhibit "G").

### Auditor's Follow-up Response

*Subsequent to the issuance of the draft audit report to Carlton for its response, the County Attorney's Office informed us that on January 3, 2008, it had made an offer to allow Carlton to deduct the \$2,250 from its rental payments. As such, we revised the audit report to eliminate this finding and recommendation that it be paid. There was no evidence that Carlton accepted this offer.*

3. The deduction from rent of \$8,560 represented only a small portion of the loss sustained by Carlton for losses sustained by Carlton on May 17, 2005.

While The Carlton had been recruited to renovate the men's locker room in May, 2005, the ladies' locker room was given on an emergency basis, without bid, to outside contractors.

The ladies' locker room is located directly above the laundry room, linen room and some storage rooms of The Carlton. It was agreed with the County that prior to any construction being commenced in the ladies's locker room, that all water service to that area would be shut off in order off to avoid damage to the Carlton. The "cowboys" hired by the County did not abide by that agreement and started construction almost immediately rupturing water lines and flooding Carlton's basement.

Mr. Capetola reported all of this to Commissioner Murphy together with Nick Thalasinis, during a conference call on May 17, 2005, complained about the County's actions and the disruption to the Carlton business as a result of this gross negligence.

Commissioner Murphy came to the scene and saw the damage personally. Customers in the Palm Court walked out because of the noise and because the water had to be shut off to the entire building, shutting running water for cooking and to our toilets and sinks in Palm Court, causing

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significant loss to our revenue.

After numerous verbal communications with Commissioner Murphy, he agreed that it was the County's responsibility for the damage but would not authorize an adjustment in rent for lost business, only for the actual physical damage to the property of The Carlton.

Letters dated May 17, 2005, July 15, 2005 and July 29, 2005 marked as Exhibit "H" annexed hereto whereby Carlton ultimately settled for damages to its property but not loss of business.

### **Auditor's Follow-up Response**

*The three letters in Exhibit H include; a request for reimbursement, a recommendation that the County withhold payment to its contractor; and a settlement offer from Carlton. Carlton provided no evidence that the County responded to, or approved this rent deduction.*

*Subsequent to the issuance of the draft audit report to Carlton for its response, the County Attorney's Office informed us that on January 3, 2008, it had made an offer to allow Carlton to split the cost for the expenses related to the flood. As such, we revised the audit report to reflect this change. There was no evidence that Carlton accepted this offer.*

4. The deduction to rent of \$6,880 for Nassau County Executive Tom Suozzi's symposium on parks was authorized by Michel Klein, Deputy County Executive.

Carlton was enlisted to host the County Executives Symposium on Parks held in February, 2005. All negotiations for this event were conducted directly with Michael Klein, then Deputy County Executive. Payments for this, I believe, came from a group known as "Friends of the Park". When the actual turnout was at least double of the number of guests anticipated by the County, payment for the outstanding balance of \$6,880 had to be resolved.

On the day of the event, Mr. Capetola spoke directly about the dilemma with Deputy County Executive Ian Siegel, who was involved with the function. Mr. Siegel referred Mr. Capetola to Mr. Klein, who subsequently authorized the payment or deduction from rent to offset the aforesaid outstanding balance; (see Exhibit "I" containing letters of March 21, 2005 to Commissioner Murphy

and March 14, 2005 to Deputy County Executive Klein).

**Auditor's Follow-up Response**

*Subsequent to the issuance of the draft audit report to Carlton for its response, the County Attorney's Office informed us that on January 3, 2008, it had made an offer to allow Carlton to deduct the \$6,880 from its rental payments. As such, we revised the audit report to eliminate this finding and recommendation that it be paid. There was no evidence that Carlton accepted this offer.*

**THE COUNTY REFUSED TO SET UP  
THE R & R ACCOUNTS**

Previous paragraphs mention and contain exhibits regarding Carlton's attempt to open an R & R account pursuant to the 2003 lease/license paragraphs. Please refer to the third paragraph of letter dated August 10, 2004 and letter dated November 10, 2005 annexed as Exhibit "A" which memorializes same.

Mr. Capetola also met with Mr. John Macari of the County in an effort to resolve the dispute. In one conversation held in an impromptu conference call with Mr. Thalasinis and a member from the Comptroller's office in 2006, it was acknowledged that the County refused to open a joint account with Carlton (of course, Carlton had long submitted signed signature cards from North Fork Bank to the County to open the account (see letter dated November 10, 2005) but the County refused to move and open the account stating it could not have a joint account with a private entity.

Again, the cause of this dispute is not Carlton's (see the terms and language of the 2003 bid which is apparently at odds with some other regulation of the County).

The solution to this is simple: Carlton will continue making the repairs on an ongoing basis and maintain the entire 19<sup>th</sup> Hole in its pristine condition and file monthly reports with the County of its expenditures for same.

**Auditor's Follow-up Response**

*We recommend that Carlton agree with Parks as to what the balance in the account should be (as if it had been funded) and set those funds aside until the account mechanism is resolved. The Comptroller's Office was not involved in any discussions regarding the opening of this account.*

*That is the purview of the Treasurer's Office.*

**OTHER AUDIT ADJUSTMENTS**

With regard to calculational computations, the Carlton avers that all are resolved.

With regard to the \$60,000 deducted, \$32,000 from May 2006 - October 2006 under the 1995 agreement and \$30,000 from April 2006 - September 2006 under the 2003 agreement, those are totally justified and proper because Deputy County Executive Michael Klein agreed to same to finally settle three issues: (1) the agreement of Carlton to give up the vending rights to Dover/Yamali because the County had previously bid those out to Dover and in order to accommodate the County's pre-existing contractual obligations, the Carlton agreed to continue granting Dover/Yamali that license; (2) the fact that the scope of time Dover/Yamali continued to operate infringed on Carlton's rights; and (3) the County's having approved plans on one hand for a facility that required 600 amp service and then refusing to deliver same, therefore forcing Carlton to rectify said omission in order to operate, causing it to sustain an expense of some \$80,000. The foregoing is memorialized in letters to Michael Klein Deputy County Executive dated August 10, 2004, August 17, 2004 and November 6, 2004 and annexed as Exhibit "D" .

**Auditor's Follow-up Response**

*We audited Carlton's compliance with the contracts, as amended and as approved by the County Legislature.*

*Carlton does not identify the "calculational computations" to which it is referring. The underpayment for the period April 2006 through September 2006 was \$30,000, not \$32,000 as stated by Carlton.*

*The three letters annexed as Exhibit "D" represent offers by Carlton, not agreements between Carlton and the County. An April 17, 2009 e-mail from Parks to the Comptroller's Office stated that, "Mr. Capetola has filed a Notice of Claim against the County for this item, claiming we breached an agreement to allow the rent abatement agreement. Our records show that this purported agreement was never executed by the County."*

## Appendix

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*In a deposition taken on September 28, 2006 regarding Carlton's Notice of Claim against the County, Carlton attempted to justify the non payment of rent as an offset to a claimed loss of business as a result of the PGA Senior golf tournament sponsored by Commerce Bank. Carlton's "justifications" provided above, were not presented as part of the deposition.*

### **THERE ARE NO DISCREPANCIES IN THE AMOUNT CARLTUN REPORTS TO COUNTY AND ITS RECORDS**

Every penny Carlton collects, properly attributable to revenues under either the 1995 or the 2003 agreement, are reported to the County.

The MICROS computerized billing system has been utilized by Carlton since its opening. The systems reports ala carte restaurant sales, catering bills are paid by check. Credit card payments for private affairs utilize MICROS when recording a payment for a function or private affair. State sales tax rules direct that a function such as a wedding, bar mitzvah, corporate entity, etc. are reported as sold as of the date of the function. Deposits for these functions are frequently recorded as deposits one or two years prior to the function actually taking place. When a MICROS credit card entry records a catering payment, the money is recorded but does not show as a sale until the day of the event. Some customers will make periodic monthly payments by credit card, month after month, so as not to be hit with a huge bill just before the function. These credit card payments are recorded through MICROS. Five to ten payments over the course of two years may be collected for a function but the sale date according to New York State sales tax rules state that the day of the event is the actual date of sale. Hypothetically, if restaurant sales recorded \$17,000 on a given day and a \$10,000 credit card payment was made, revenues of \$27,000 would be recorded. In this instance, sales for such a day would be \$17,000, the \$10,000 credit card payment would be recorded later as a sale, on the date of the event to which the \$10,000 event applied.

These circumstances have led The County's audit to erroneously conclude in this regard that all sales are reported when money is paid, because of the foregoing, such conclusion is erroneous.

## Appendix

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### **Auditor's Follow-up Response**

*Our reconciliations have already taken into account the fact that customer deposits do not represent revenue until after the event takes place. Footnote 32 in the report states "For purposes of this reconciliation of the Micros reports, we did not include gift card sales or customer deposits because Carlton initially reports these as liabilities. When the gift certificates are redeemed or the customer affair is completed, the revenue is then recognized." Carlton does not explain the differences noted in the audit report.*

*Carlton did not address the issue of the discrepancies with the reclassification of the Mother's Day and Father's Day restaurant sales to catering sales. We stand by our audit findings and recommendations as stated in the audit report.*

### **RECORD RETENTION**

All records of The Carlton on maintained in accordance with GAPP principles and are full and complete. Its impossible to have signed contracts with money customers as some are long-term customers whose integrity is insulted by having them even sign a contract. Customers appear a day or two before a scheduled event and book a function within days. This is typical of funeral lunches, celebrations on bar passage or admittance to the bar, the winning of a case by a lawyer or saving of a life by a doctor.

All of the above do not have a contract because of the impromptu nature of the event. The alternative is for these customers in this very hard economic time to go to a competitor who will accord them latitude.

### **Auditor's Follow-up Response**

*We stand by our audit findings and reiterate our recommendations. Contracts protect both parties and could be written to provide flexibility due to the impromptu nature of certain events. Carlton's response did not address our recommendations that contracts be prenumbered and accounted for, that logbooks be established, and that documentation be retained for audit purposes.*

### **INTERNAL CONTROLS SURROUNDING SALES**

The Micros system is also an ordering system. A waiter may on a "lunch day special" receive four orders for lunches from a table but there are newspaper advertised "2 for 1" coupons available to stimulate business. When the check is rung on those four lunches, two would be voided to allow for newsprint discounts. Seniors love this special offer. When the check is recorded as a sale, there is a promotional discount recorded and the newsprint attached to the final check. The auditors are welcome to review these

## Appendix

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on a check by check basis and Carlton's accountants made these available to the auditors.

Further, returns of void for wrong orders, over or undercooked foods cause a "void" to be entered in the system when a new order is then entered. Further test orders to sample the accuracy of the system, monitors the honesty of waiters and complimentary orders for samples for future customers do not result in revenues, though recorded in the system.

### **Auditor's Follow-up Response**

*We stand by our findings and reiterate our recommendations. Our report notes that Micros has the ability to account for promotional discounts. Carlton did not use that feature, and instead merely voided the meals from the daily sales.*

**ALL PERFORMANCE BONDS & INSURANCE REQUIREMENTS  
HAVE BEEN COMPLIED WITH AS WELL AS ALL  
FINALIZED STATEMENTS OF CARLTUN ON THE PARK**

On a yearly basis, all records of the Carlton including performance bonds, insurance policies and financial statements have been submitted to the County directly to Nicholas Thalasinis during the audit period. Duplicate copies of all are available for your review.

**Auditor's Follow-up Response**

*Carlton's response does not address our findings that the insurance covering and performance bond levels were not adequate during the audit period.*

**CONCLUSION**

Based upon the foregoing, there appears to be no money due the County during the audit years.

**Auditor's Follow-up Response**

*We reiterate all findings and recommendations as stated in our audit report.*