

AUDIT REPORT



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

Audit Report on the Department of Housing Preservation and Development's Administration of the J-51 Tax Incentive Program

FR06-067A

March 22, 2007



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

WILLIAM C. THOMPSON, JR.
COMPTROLLER

To the Citizens of the City of New York

Ladies and Gentlemen:

In accordance with the responsibilities of the Comptroller contained in Chapter 5, § 93, of the New York City Charter, my office has audited the administration of the J-51 Tax Incentive Program by the Department of Housing Preservation and Development.

Under the provisions of the J-51 program, the Department of Housing Preservation and Development can issue certificates-of-eligibility to property owners who rehabilitate their residential buildings or convert their commercial properties to residential use. The certificate allows the property owner to obtain tax exemptions and abatements. We audit programs such as this to ensure that programs that provide tax benefits are being administered in accordance with applicable laws and regulations.

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

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

Very truly yours,

A handwritten signature in black ink, appearing to read "William C. Thompson, Jr.", written over a horizontal line.

William C. Thompson, Jr.

WCT/fh

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*The City of New York
Office of the Comptroller
Bureau of Financial Audit*

**Audit Report on the Department of Housing
Preservation and Development's Administration of the
J-51 Tax Incentive Program**

FR06-067A

AUDIT REPORT IN BRIEF

We performed an audit of the Department of Housing Preservation and Development's (Department) Administration of the J-51 Tax Incentive Program. Under the J-51 program, which was created in 1955, the Department provides tax exemption and abatement benefits to owners of residential properties who rehabilitate their buildings and to owners of non-residential buildings who convert their buildings to residential use. The Department is responsible for administering the program, verifying eligibility, determining whether the cost of the work is supported, calculating a "certified reasonable cost," and issuing certificates-of-eligibility. (The Department of Finance is responsible for implementing benefits granted under the program.) In Fiscal Year 2004, the program provided \$189.1 million in tax benefits.¹ The Department issues a certificate-of-eligibility to property owners who meet program requirements.

To obtain an exemption or abatement, applicants must, within specific time periods, perform eligible construction work (such as major capital improvements) for specific project types. Exemptions are granted for a period of either 14 or 34 years, based on the type of project. Abatements are granted for a period of up to 20 years.

Audit Findings and Conclusions

While the sampled applications consisted of project types that qualified for inclusion in the J-51 program and applicants performed eligible work, we found deficiencies in the Department's system of internal controls for administering the program. Specifically, the Department did not ensure that all required documentation was submitted and that applications for final benefits and subsequent submissions were made within required time frames. As a result, the Department improperly certified reasonable costs totaling \$2,546,300 and improperly awarded certificates-of-eligibility to 25 of 56 sampled properties associated with those

¹According to the New York City Department of Finance "Annual Report on Tax Expenditures" for Fiscal Year 2004.

applications. Accordingly— these 25 applicants are obtaining tax benefits to which they are not entitled.

In addition, the Department incorrectly calculated the certified reasonable cost in 21 percent of the sampled properties. As a direct result of the certified reasonable costs being incorrectly computed, the fees that applicants were charged were also incorrect.

Moreover, the Department has not ensured that required inspections of J-51 work are adequately conducted. Department files lacked evidence that 7 of 51 required inspections were conducted. Of the 44 required inspections that were conducted, we found problems in 10 cases (23%) and in one additional property that the Department inspected although an inspection was not required. As a result, the Department improperly certified reasonable costs totaling an additional \$310,775.

Finally, we found problems with some of the procedures for auditing J-51 applications and discrepancies between the Rules of the City of New York (Rules) and the Department's procedures.

Audit Recommendations

This report makes a total of 15 recommendations. The major recommendations are as follows:

The Department should:

- Ensure that appropriate Department staff are instructed in program policies and Rules.
- Process applications, award certificates-of-eligibility within the Department's five-month time frame, and ensure that work inspections are conducted promptly after applicants submit final applications.
- Implement internal controls to ensure that required inspections are adequately conducted and supervised and instruct inspectors to identify and disqualify improperly installed work.
- Review the applications discussed in this report to ensure their eligibility for J-51 benefits. Adjust the certified reasonable costs for the cases cited in this report section, and advise the Department of Finance about any changes that would affect J-51 benefits.
- Record and properly maintain all supporting documentation in Department files. Computerize certified reasonable cost calculations.
- Develop sufficient procedures for auditing applications and train auditors in their use.

INTRODUCTION

Background

The New York City Department of Housing Preservation and Development (Department) is the largest municipal developer of affordable housing in the nation. The Department's mission is to promote quality housing and viable neighborhoods for all New Yorkers. To fulfill this mission, the Department uses a variety of preservation, development, and enforcement strategies, and works with private, public, and community partners to strengthen neighborhoods.

Under the J-51 program the Department provides tax exemption and abatement benefits to owners of residential properties who rehabilitate their buildings and to owners of non-residential buildings who convert their buildings to residential use. The Department is responsible for administering the program, verifying eligibility, determining whether the cost of the work is supported, and calculating a "certified reasonable cost." (The Department of Finance is responsible for implementing benefits granted under the program.) In Fiscal Year 2004, the program provided \$189.1 million in tax benefits. The Department issues a certificate-of-eligibility to property owners who meet program requirements.

The program was created in 1955 under legislation authorized by the New York State Real Property Tax Law (Section 489). According to Chapter 5, Title 28, of the Rules of the City of New York (Rules), to obtain an exemption or abatement, applicants must, within specific time periods, perform eligible construction work (such as major capital improvements) for specific project types. Exemptions are granted for a period of either 14 or 34 years, based on the type of project. Abatements are granted for a period of up to 20 years.²

Applicants should file two forms, J-11 ("Notice of Intent to file for J-51 Tax Exemption and Tax Abatement") and J-5A ("Affidavit of Non-Harassment") prior to starting construction.³ If the work includes a moderate rehabilitation, applicants must also file a "Rehabilitation Notice to Tenants" and a "Moderate Rehabilitation Affidavit." After construction has commenced, an applicant must complete project work and file within 48 months an application for benefits, consisting of forms J-1 ("Project Information Sheet") and J-2 ("Itemized Schedule"). Finally, an applicant must complete the application process by submitting other required documentation, such as form J-3 ("Certificate of Compliance with Department of Buildings Regulations"), within 24 months of filing.

² Under a tax exemption, a property's assessed value will not be increased for tax purposes as a result of completing improvements. In contrast, a tax abatement reduces a property's existing tax by a percentage of the certified reasonable cost.

³ Failure to submit, or a late submission of the J-11 form does not disqualify an applicant from program participation; however, the applicant will be assessed a penalty. If an applicant does not submit a J-5A form before construction, the Department may accept a J-5B form ("Affidavit of Non-Harassment—Late Filing"), in which case a penalty will not be assessed.

Applicants whose projects are funded under a Department loan program or other government-assisted programs are permitted to file respectively either a “streamline” or a “shortform” application, which requires less documentation and different time milestones than the regular application. For example, the “certified reasonable cost” computation for shortform applications is simplified and based upon the number of dwelling units. In addition, projects filed under “streamline” or “shortform” applications are monitored and inspected by the Department or by a Department-approved construction monitor. For projects filed under a streamline application, a Department mortgage officer files the application on behalf of the owner.

The J-51 program is administered by the Department’s Tax Incentive Programs Unit, which consists of two components, each including a supervisor and four staff members: an intake unit that receives applications, processes forms, and tracks incoming documentation; and, a processing unit that reviews applications and determines their eligibility. Staff of the processing unit identify required documentation and notify an applicant of any missing documents or application deficiencies. In addition, processors determine whether specific improvements are eligible for J-51 benefits and ascertain allowable work quantities. Processors also compute a “certified reasonable cost” by calculating the lesser of the applicant’s actual cost for each improvement or the cost for the item as stated in the Department’s itemized cost breakdown schedule. After improvements are completed and all required documentation is submitted by applicants, certificates-of-eligibility are issued by the processing unit to applicants who are deemed entitled to receive J-51 benefits.⁴ However, for an applicant to in fact receive an exemption or abatement, the applicant must submit the certificate-of-eligibility to the Department of Finance.

In addition to the Tax Incentive Programs Unit, two other Department entities are involved in administering the J-51 program. The Division of Architecture, Construction & Engineering (Division) verifies work quantities by inspecting properties associated with applications for which benefit requests exceed \$10,000. The Department’s Management Review and Internal Compliance unit conducts post-audits of payments made by applicants to their contractors to ensure that work was done and paid for properly. The Management Review unit audits all J-51 project applications whose “certified reasonable cost” is \$100,000 or greater, and randomly audits selected applications under \$100,000.

Objectives

The objectives of this audit were to determine whether the Department of Housing Preservation and Development is ensuring that properties meet J-51 program requirements; whether improvement work is eligible and completed in a timely manner; and whether all required documentation is submitted.

⁴ Since all qualified projects are entitled to receive an abatement (subject to limitations stated in the Rules), certified reasonable costs are routinely computed for all projects. However, only projects that trigger an increase in the assessed value of a building (i.e., those with substantial work scopes) can receive an exemption. The Department is not responsible for determining whether or not the work resulted in an increase in assessed value. The exemption granted under the J-51 program temporarily exempts the property from taxes resulting from this increase; it is not dependent on the certified reasonable cost.

Scope and Methodology

The scope of this audit covered projects in the J-51 Tax Incentive Program for which certificates-of-eligibility were issued by the Department in Fiscal Years 2004 and 2005 and projects whose applications were withdrawn or rejected in Fiscal Years 2004 and 2005. We obtained from the Department the entire J-51 application database of projects and their associated properties. Using this database, we conducted data reliability testing for completeness by searching for gaps in sequentially assigned application numbers. We randomly selected 100 hard-copy files and compared their docket number and application date information with the corresponding fields on the database. Our population consisted of 2,087 applications for which the Department awarded certificates-of-eligibility during Fiscal Years 2004 and 2005. The total certified reasonable cost for our population was \$316,658,200. Of these applications, 14 were categorized as streamline (whose total certified reasonable cost was \$2,328,400), 170 were shortform (whose total certified reasonable cost was \$43,340,000), and 1,903 were regular (whose total certified reasonable cost was \$270,989,800). In addition, 357 applications were withdrawn or rejected during Fiscal Years 2004 and 2005.

From our population of 1,903 regular applications, we selected a random sample of 50 (whose total certified reasonable cost was \$4,540,000). In addition, we chose a random sample of 2 of the 14 streamline applications (whose total certified reasonable cost was \$212,700) and 5 of the 170 shortform applications (whose total certified reasonable cost was \$660,000). The Department approved certificates-of-eligibility for these 57 applications with a total certified reasonable cost of \$5,412,700. The Department was unable to provide us with one of the 57 sampled applications (streamline Docket number 95/1154), which reduced our sample to 56 applications with a total certified reasonable cost of \$5,338,300.

From the population of 357 withdrawn and rejected applications, we selected random samples of 5 applications that were withdrawn and 2 applications that were rejected.⁵ Finally, we selected a random sample of 2 of the 17 applications in our population of 2,087 that were audited by the Department's Management Review and Internal Compliance unit.

We reviewed the following Rules and regulations governing the program:

- J-51 Rules (Chapter 5, Title 28, of the Rules of the City of New York) (revised April 2005),
- *J-51 Guidebook* (revised April 2005),
- *Field Inspection Guide* (revised December 1993)

To understand the Department's internal controls for granting certificates-of-eligibility and administering the program, we reviewed Department policies and procedures, and interviewed Department personnel who oversee the program. We documented our understanding of these controls in flowcharts and written descriptions.

⁵ The Department was in the process of reinstating to active status one of the sampled applications that had been rejected. Consequently, we did not review this application.

To determine whether the Department is ensuring that properties meet program requirements and that improvement work was eligible, we reviewed information contained in the sampled file applications. To determine whether work was completed in a timely manner, we examined documentation to verify that eligible work was completed within allowable time periods. In addition, the Department's certificate processing time was analyzed to ensure that applicants could receive benefits promptly.

To determine whether certified reasonable costs were being correctly computed, we reviewed the accuracy of computations for mathematical errors, proper use of the cost breakdown schedule, and the application of various required reduction factors. We also conducted field inspections for the 56 sampled regular, streamline, and shortform applications to observe that work was performed and completed. Our inspections were conducted from February 21, 2006, to March 20, 2006. In addition, we accompanied a Department inspector on November 21, 2005, to observe procedures for carrying out typical J-51 inspections. Our own inspections were limited to visual observations of completed work because we were unable to inspect underground, in-wall, or other construction work that was covered by finishing materials.

To determine whether all required documentation was submitted, we reviewed file applications to confirm whether all required documents were present and properly completed.

To determine whether applications were properly rejected or withdrawn, we reviewed file documentation to determine whether the applications were rejected or withdrawn in accordance with appropriate Department procedures.

The results of the above tests, while not statistically projected to the populations from which the samples were drawn, provide a reasonable basis for us to assess the Department's performance in accordance with our audit objectives.

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

Discussion of Audit Results

The matters covered in this report were discussed with Department officials during and at the conclusion of this audit. A preliminary draft report was sent to Department officials and discussed at an exit conference held on September 7, 2006. On November 16, 2006 we submitted a draft report to Department officials with a request for comments. We received the Department's December 8, 2006 written response on December 12, 2006.

In their response, Department officials stated, "We are pleased with your determination that the sampled applications consisted of project types that qualified for inclusion in the J-51 program, and that applicants performed eligible work." However, they stated that the Department "disagrees with the auditors' conclusion that there are deficiencies in HPD's [the

Department's] system of internal controls for administering the program. HPD disagrees with many of the exceptions noted by the auditors in their review of the agency's files.”

The Department agreed with six recommendations and disagreed with one recommendation. The Department contended that it already implemented eight recommendations.

The full text of the Department's response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

While the sampled applications consisted of project types that qualified for inclusion in the J-51 program and applicants performed eligible work, we found deficiencies in the Department's system of internal controls for administering the program. Specifically, the Department did not ensure that all required documentation was submitted and that applications for final benefits and subsequent submissions were made within required time frames. As a result, the Department improperly certified reasonable costs totaling \$2,546,300 and improperly awarded certificates-of-eligibility to the 25 properties associated with those applications.

In addition, the Department incorrectly calculated the certified reasonable cost in 21 percent of the sampled properties (12 of the 56 cases). In five cases, the amount of the certified reasonable cost was \$10,836 greater than the \$545,564 it should have been; in another seven cases, the amount was \$23,614 less than the \$443,614 it should have been. As a direct result of the certified reasonable costs being incorrectly computed, the fees that applicants were charged were also incorrect. Also, the Department did not charge applicants a total of \$840 in additional filing fees (i.e., penalties) for failing to conduct violation searches as required by Rules §5-05(f)(2).

Moreover, the Department has not ensured that required inspections of J-51 work are adequately conducted. Department files lacked evidence that 7 of 51 required inspections were ever conducted. Of the 44 required inspections that were conducted, we found problems in 10 cases (23%). Our inspections also uncovered problems at one additional property that the Department inspected although an inspection was not required. As a result, the Department improperly certified reasonable costs totaling an additional \$310,775.

Finally, we found problems with some of the procedures for auditing J-51 applications and discrepancies between the Rules and the Department's procedures.

These matters are discussed in the following sections of this report. Appendix I lists the specific exceptions we identified.

Deficiencies in Reviewing and Approving Applications for Program Benefits

The Department does not have sufficient internal controls to ensure that it properly reviews and approves applications for certificates-of-eligibility; that it does so in a timely manner; and that applicants fulfill all program requirements before being granted certificates-of-eligibility. As a result, the Department awarded 25 certificates-of-eligibility whose certified reasonable costs totaled \$2,546,300 to applicants who did not submit all required project documentation or meet required time frames. Accordingly— these 25 applicants are obtaining tax benefits to which they are not entitled.

Section 5-05 of the Rules require that applicants fulfill certain requirements in order to be granted a certificate-of-eligibility. Typically, these include submitting to the Department's Tax Incentive Programs Unit: a pre-filing consisting of forms J-11 ("Notice of Intent to file for J-51

Tax Exemption and Tax Abatement”) and J-5A (“Affidavit of No Harassment”) prior to starting construction; an initial filing consisting of forms J-1 (“Project Information Sheet”) and J-2 (“Itemized Schedule”) within 48 months of commencing construction; and completion of the application by submitting other required documentation, such as form J-3 (“Certificate of Compliance with Department of Buildings Regulations”), within an additional 24 months of the initial filing. The Department’s Division of Architecture, Construction & Engineering (Division) verifies work quantities by inspecting properties associated with applications for which benefit requests exceed \$10,000. After the Department has received all required documentation, §5.D of the Department’s *J-51 Guidebook* states that “files are generally processed within three to five months.”

The specific deficiencies in reviewing and approving applications that we identified are discussed below.

Problems with Reviewing and Processing Applications

The Department improperly certified reasonable costs totaling \$2,546,300 and granted certificates of eligibility to 25 of the 56 sampled cases (45%) although they were not entitled according to the Rules and Department procedures. Section 5.05 (a) of the Rules states, “Only applications complete in all detail will be considered for certification of eligibility and reasonable cost. All forms must be filled out fully and legibly.”

Furthermore, the Rules require that project construction and the application (including submission of all required forms and supporting documentation) must be completed within specified timeframes. However, one of the 25 cases cited failed to comply with both the documentation and timeframe requirements; 17 cases had documentation exceptions; and 7 cases had timeframe exceptions. Submission of a complete application is important to ensure that work is eligible for program benefits and building and rent regulations are properly followed.

Department Response: “HPD [the Department] disagrees with the documentation exceptions for 13 of the 18 files identified by the auditors. Of the 23 individual exceptions cited, HPD disagrees with 18. On 3 of the exceptions with which we disagree, the auditors misinterpreted program requirements (03/0737, 03/0753, 04/0323); on 3 other exceptions, the auditors incorrectly assume that Form J-5B was not properly completed by the applicant (03/0811, 03/1258, 04/0347); and on the remaining 12 exceptions, we disagree with the auditors’ application of program rules and requirements in an overly technical manner.”

Auditor Comment: We conducted our audit by examining the Department’s compliance with J-51 program rules and requirements. Contrary to the Department’s contention, we applied the rules as that are stated. We believe that many of the exceptions we identified resulted from the Department’s lax manner in applying certain rules.

For example, the Department claimed that form J-8 was not required for docket numbers 03/0737 and 03/0753 because the associated properties are co-ops. However, the rules require that the form be submitted in these specific cases because the co-ops also contain

rent stabilized units. Furthermore, we believe that the Department incorrectly assumed that the J-5B forms (affidavit of non-harassment which certifies that property owners have not been found to have harassed or unlawfully evicted tenants) were properly completed, even though the forms lacked the names of any owners whose interest in the properties was greater than ten percent. If there were no such owners, we would expect to see the word “none” indicated on the form. A blank entry leads one to question whether owners are attempting to avoid certification of non-harassment.

The Department should apply the existing rules consistently and accurately. If, however, the Department believes that the rules need to be more lenient, it should seek formal revisions to the rules rather than making changes subjectively or inconsistently.

We strongly dispute the Department’s unsubstantiated allegation in footnote 1 of its response that “documents in the sampled files had been misfiled by the auditors.” Our auditors conduct their reviews according to stringent professional standards. Moreover, the allegation appears to be an attempt to obscure the condition of the Department’s record room that we found when we commenced our survey of files for the audit scope period: the files were disorganized, haphazardly contained in boxes, and not filed in any particular order.

Department Response: “HPD also disagrees with the timeframe exceptions for 7 of the 8 files identified by the auditors. On 2 of the 7 exceptions with which we disagree, the auditors apparently miscalculated the period between the construction start date and the filing of the application with HPD (03/0868, 99/0669); and on the 5 remaining exceptions, the auditors misinterpreted program requirements or disagreed with longstanding policies and practices in HPD’s administration of the program.”

Auditor Comment: We again disagree with the Department’s contention that we misinterpreted program requirements. Regarding the first two timeframe exceptions referred to in the Department’s response, the Department did not provide us with adequate documentation to substantiate its claim that those applications adhered to appropriate timeframes. Regarding the other five exceptions, a thorough review of the files indicated that the Department is basing its disagreement on certain assumptions or inconsistent procedures (e.g., granting an automatic extension to applicants although Department officials had informed us that applicants had to request such extensions). Therefore, as stated above, the Department should apply the existing rules consistently and accurately.

Problems with Timeliness in Reviewing Applications

In 6 (11%) of 56 cases, the Department did not issue certificates-of-eligibility in accordance with its guidelines. In five cases, the Department exceeded its required five-month time frame for processing applications and awarding certificates-of-eligibility. In these cases, applications were processed between 12 and 291 days late. As a result, applicants were not able to obtain benefits on a timely basis. In one additional case, a certificate-of-eligibility was improperly awarded 38 days before the application was complete.

Department Response: “HPD also disagrees with the auditors’ decision to base exceptions on a non-existent deadline for a determination on eligibility 3 to 5 months from completion of the application. This timeframe is included in the J-51 Guidebook to provide applicants and owners new to the J-51 program with an estimated timeframe within which they can expect to receive a certificate of eligibility. The J-51 rules do not include a mandatory or suggested timeframe to complete the processing of an application.”

Auditor Comment: Our audit clearly stated that the application processing timeframe is stated in the Department’s *J-51 Guidebook* and not in the J-51 program rules. Therefore, the Department’s contention that the three- to five-month timeframe is non-existent is incorrect. As noted in the audit, we allowed the Department the benefit of doubt by analyzing the processing time on the basis of five months, not three. Nevertheless, 11 percent of examined cases still exceeded the Department’s own processing timeframe.

In an additional three cases, the Department could have conducted more timely inspections after receiving final applications from applicants, rather than conducting the inspections after all documentation required to complete the application process was submitted. Although in these instances the Department awarded the certificates-of-eligibility within the required five-month time frame, conducting inspections promptly after applicants submit final applications is an important means for ensuring that delays in processing certificates-of-eligibility do not occur.

Problems with Calculating Certified Reasonable Cost and Fees

In 12 (21%) of 56 cases, the Department incorrectly calculated the certified reasonable cost. In five cases, the amount of the certified reasonable cost was \$10,836, in the aggregate, greater than the \$545,564 that it should have been; in another seven cases, the amount was \$23,614, in the aggregate, less than the \$443,614 that it should have been. We found that Department staff used incorrect unit costs, did not apply or applied incorrect “de-control reduction” amounts, or did not account for non-residential space when computing the certified reasonable costs for these cases.⁶ Processors also disallowed items without maintaining supporting documentation in the application file.

Department Response: “HPD disagrees with the calculation exceptions in 8 of the 12 files identified by the auditors.”

Auditor Comment: Our calculations of certified reasonable costs are based on J-51 program rules. On several occasions we discussed with Department officials how we performed our calculations and sought to reconcile any differences between our calculations and theirs. We conclude that the Department’s objections to our calculations

⁶ According to the Rules, apartment units that are permanently exempt from rent regulations are ineligible for J-51 benefits. Accordingly, the Department must reduce the amount of a property’s certified reasonable cost to account for any such units. Co-op and condo units are not subject to this requirement.

are based on its looser interpretation of program rules (e.g., we reduced benefits for superintendent units which are permanently exempt, whereas the Department did not). In addition, the Department could not provide us with sufficient documentation to substantiate its position in certain cases. Consequently, we affirm the validity of our noted calculation exceptions.

As a direct result of the certified reasonable costs being incorrectly computed, the fees (which are based on the certified reasonable costs) that applicants were charged were also incorrect. Furthermore, in 28 cases the Department did not charge applicants a total of \$840 in penalties for failing to conduct violation searches as required by Rules §5-05(f)(2).

Department Response: “The auditors claim that in 28 cases the Department did not charge applicants a \$30 processing fee to obtain a violation search report from HPD’s Division of Code Enforcement (28 RCNY §5-05(f)(2)). Each of these applications contains a copy of the violation search report submitted by the applicant, frequently obtained through a private reporting service; therefore, no processing fee was required and none was charged.”

Auditor Comment: According to the Rules, violation search reports must be submitted simultaneously with the application filing and fee; if the report is not submitted at that time a penalty is to be charged. Rules §5-05(f)(2) states, “if a Code Violation Search report is not submitted with an application . . . an additional non-refundable filing fee . . . currently thirty dollars (\$30) . . . must be submitted to cover the cost of processing such search. This fee must be submitted simultaneously with the five hundred dollar (\$500) application fee.” Although some of the cited applications do contain a violation search report submitted by the applicant, they were submitted late. Other applications did not contain a violation search report at all. Therefore, according to the rules, the penalty should have been charged in these cases.

We also noted that there was no written procedure to ensure that processors were “rounding” certified reasonable cost computations consistently. At the exit conference, Department officials described to us the specific rounding procedure that processors must follow. After reviewing the cost computations, we found that processors generally adhered to this procedure. While Department officials told us it was in the process of automating the computation process to enable it to derive exact computations, we were not provided with any evidence of such automation.

Finally, for 3 (5%) of the 56 cases, Department processors did not record their computations on the J-2 form as required. Therefore, in these cases we were unable to determine why the certified reasonable costs computed by Department processors differed from the certified reasonable costs we computed.

Department Response: “Based upon other documentation in the files, HPD is confident that the processors recorded their computations on Form J-2, that the computations were reviewed by the J-51 supervisors prior to issuance of the certificates of eligibility, and that the forms have since been lost or misplaced.”

Auditor Comment: The Department contends that it has other documentation that will demonstrate that its processors recorded their computations on Form J-2. However, as stated in our audit, the actual J-2 forms that we examined lacked the required computations. Any other documentation is irrelevant.

The amount of an applicant's tax abatement is dependent on an accurate calculation of the certified reasonable cost. According to §3.C of the Department's *J-51 Guidebook*, the certified reasonable cost is determined by applying the lesser of the applicant's actual costs or the cost listed in the Rules' itemized cost breakdown schedule. As a result of improper certified reasonable cost calculations, applicants may either be obtaining excessive tax benefits or may not be obtaining the full benefit to which they are entitled. In either case, the Department needs to ensure that it accurately calculates certified reasonable costs.

J-51 Improvements Funded by an Energy Conservation Grant

In another matter, the Department approved two certificates-of-eligibility (Docket Nos. 04/0990 and 05/0285) for installing new windows at the premises at 2200 East Tremont Avenue and 1519 Metropolitan Avenue in Parkchester in the Bronx that were funded by a \$4.7 million grant from the New York State Energy Research and Development Authority.⁷ The Rules require that applicants for J-51 benefits complete eligible improvements. Our own inspection verified that the improvements were completed in these two cases. Nevertheless, we are concerned that the award of J-51 benefits in these cases does not comport with the program's intent of revitalizing the City's housing stock, given that the applicant carried out the work anyway under an unrelated energy conservation program. Therefore, the Department should consult with its general counsel to determine whether program Rules should be revised to preclude applicants from this form of "double-dipping," in which multiple benefits for identical work are obtained from separate government entities.

Recommendations

The Department should:

1. Ensure that appropriate Department staff are instructed in program policies and Rules. In that regard, Department staff should adhere to procedures for approving certificates-of-eligibility by ensuring that applicants submit all required documentation and complete work within required timeframes.

Department Response: "HPD disagrees that there are deficiencies in reviewing and approving applications. HPD does agree, however, and does ensure, that appropriate staff should be and are instructed in program policies and rules. . . . The J-51 supervisors have created a reference manual for the processors' use and review every file before the Certificate of Eligibility is issued to ensure compliance with the Rules and Regulations."

Auditor Comment: Contrary to the Department's contention, our audit identified deficiencies in reviewing applications and approving certificates-of-eligibility. Although

⁷ The grant funding also included other energy efficiency improvements.

we asked the Department for all its policies and procedures pertaining to the J-51 program, we were never informed about, nor provided with a copy of the purported reference manual. Nevertheless, as stated in our recommendation, we welcome the Department's efforts in instructing appropriate staff in program policies and rules.

2. Process applications and award certificates-of-eligibility within the Department's five-month timeframe.

Department Response: "HPD agrees that applications should be processed within five months of receipt of all required documentation. However, this five-month timeframe is a guideline which the J-51 program has established for itself and is not mandated by law or rule."

3. Record and properly maintain all supporting documentation in Department files.

Department Response: "HPD agrees and does adequately ensure that all supporting documentation should be and is in fact recorded and properly maintained in Department files."

Auditor Comment: As previously stated, our survey of files found them to be disorganized, haphazardly contained in boxes, and not filed in any particular order.

4. Ensure that work inspections are conducted promptly after applicants submit final applications.

Department Response: "HPD disagrees that there are problems with timeliness in reviewing applications. HPD agrees and does adequately ensure that inspections are conducted promptly after submission of final applications."

Auditor Comment: Our recommendation is intended to improve the Department's application review process by ensuring that non-timely inspections do not cause application processing delays. This recommendation is necessary because in three cases, the Department conducted inspections after the Department obtained all required documentation for the final applications. Therefore, while there was no delay in processing the applications for the three cited cases, we believe that the Department's overall effectiveness can be improved by ensuring that inspections are conducted in a timely fashion.

5. Computerize certified reasonable cost calculations.

Department Response: "HPD agrees that calculations of certified reasonable costs should be performed using a computerized program."

6. Review the applications discussed in this report to ensure their eligibility for J-51 benefits.

Department Response: “HPD agrees to review the applications discussed in the auditors’ report.”

7. Consult with its general counsel to determine whether program Rules should be revised to preclude applicants from obtaining J-51 benefits if they are obtaining—or have already obtained—benefits for identical work from separate government entities.

Department Response: “HPD agrees to consult its general counsel regarding the possible revision of program rules to preclude applicants from obtaining J-51 benefits for work subsidized by other governmental entities. However, HPD notes that the state and local laws governing the J-51 program provided benefits for projects funded by energy conservation grants and other governmental loans, grants or subsidies.”

The Department Is Not Ensuring that Adequate Work Inspections Are Conducted

The Department has not ensured that required inspections of J-51 work are adequately conducted. We identified problems with inspections in 18 cases as follows. In 7 (14%) of 51 cases for which inspections were required, Department files lacked evidence that the inspections were ever conducted. Additionally, we inspected 43 of the 44 cases for which the Department required and conducted inspections, and found problems in 10 (23%) of the 43 cases.⁸ Our inspections also uncovered problems at one additional property that the Department inspected although an inspection was not required in that case. As a result, the Department improperly certified reasonable costs totaling \$315,564 for the 11 cases in which the Department did conduct inspections. Of this amount, \$310,775 is additional to the \$2,546,300 in certified reasonable costs that we deemed improper because applicants failed to adhere to documentation or time requirements.

Department procedures require that inspections be conducted if the cost of improvement work exceeds \$10,000. Insofar as the actual inspection process is concerned, the Department’s *J-51 Field Inspection Guide, Field Inspection Requirements* states that inspectors must “make an actual field inspection of each building and check every item claimed on the application.” Furthermore, Department procedures require that inspectors verify work quantities, and ensure that work was actually completed and properly installed.

We attribute \$297,150 of the total \$315,564 in improperly certified reasonable costs to 1 of the 11 cases in which our inspections uncovered problems. In this case, Department inspectors validated an incorrect quantity (accounting for \$525 in improperly certified reasonable costs) and also failed to observe that improperly-sized windows were installed (accounting for \$296,625 in improperly certified reasonable costs). Our inspection of the premises at 97-11 Horace Harding Expressway in Queens (Docket No. 04/0261) found that 1,695 new windows leaked excessive air through the window seals due to a manufacturing defect. This defect

⁸ The audit team was not granted access by the property’s manager to one of the sampled properties (Docket No. 02/0353).

adversely impacts the windows' energy conservation function. In contrast, the Department inspector validated the installation of 1,698 new windows.

In 7 of the 11 cases, Department inspectors verified work quantities different than those actually installed. (In five of the seven cases, quantities were greater than actually installed; in two cases, quantities were less.) For example, our inspection of the premises at 42-07 Elbertson Street in Queens (Docket No. 04/0323) found that the applicant pointed 1,000 square feet of brickwork. In contrast, the Department's inspector reported that 1,800 square feet of pointing was done. In another example, our inspection of the premises at 35-38 75th Street in Queens (Docket No. 03/1088) found that the applicant installed a 6,100 gallon capacity oil tank. In contrast, the Department's inspector reported that the oil tank's capacity was 6,150 gallons.

Department Response: "HPD inspectors conduct inspections of all the claimed items. The Department's inspection is based upon visual observations and documents provided by the applicant. Where the quantities of our inspections differ from those provided by the applicant, it is our policy to allow the lesser quantity. We believe this policy prevents the approval of unsubstantiated work."

Auditor Comment: Contrary to the Department's contention, its inspections do not appear to prevent the approval of all unsubstantiated work. In five of the seven cases we cited, our independent inspections found that quantities verified by Department inspectors were greater than those actually installed.

For 3 of the 11 cases, Department inspectors failed to disqualify improperly installed work from inclusion as part of the certified reasonable costs. For example, our inspection of the premises at 8831 Fort Hamilton Parkway in Brooklyn (Docket No. 02/0523) found that 600 out of 1,000 square feet of brick pointing should not have been considered valid because it was deteriorated and in poor condition. (See photograph #1 in Appendix II.) In contrast, the Department inspector considered all the pointing work valid. In another example, our inspection of the premises at 223 Anns Avenue in the Bronx (Docket No. 04/0983) found that 1,870 square feet of roofing should not have been considered valid because it was poorly installed with an improper pitch and showed signs of water leakage. (See photograph #2 and #3 in Appendix II.) In contrast, the Department inspector considered all the roofing work valid. As the final example, our inspection of the premises at 259 West 113 Street in Manhattan (Docket No. 03/0426) found that the quality of 2,000 square feet of cement waterproofing was poor, with signs of interior water leakage. (See photograph #4 in Appendix II.) In contrast, the Department inspector considered all the cement waterproofing work valid.

Department Response: "We believe the photographs included in the report provide a misleading and inaccurate picture with respect to the quality of work at the time of completion. The work identified in each of the photographs was inspected following work completion several years ago. In most cases, the Comptroller's audit was conducted 2 to 3 years following the J-51 application review."

Auditor Comment: The photographs were taken at the time we conducted our audit inspections and clearly show that the work had been improperly carried out. The work

may have been done several years ago, as the Department contends, but deficiencies such as a poor roof pitch and improperly-sized windows would certainly have been evident at that time.

While our observations of a Department inspector revealed that inspectors do not have adequate equipment (e.g., tape measures, measuring wheels, flashlight, circuit tester, camera) to carry out their duties, most of the problems with inspections can be attributed to the Department's lack of internal controls. Interviews with Department officials indicate that Division inspectors are solely responsible for reviewing and approving work quantities and that the work of inspectors lacks supervisory review. Thus, if an applicant disputes an inspector's report of work quantities, the dispute is resolved entirely between the inspector and the applicant. In addition, if an applicant asks to have a property reinspected, the same inspector conducts the reinspection as well. Clearly, the Department needs to implement more effective internal controls to ensure that its current practices do not leave the inspection process vulnerable to fraud and abuse.

Department Response: "DACE [Division] was not presented with an opportunity to review the inspection data relied on by the Comptroller's Office auditors which noted specific dockets as 'CRC Computation Exceptions (total allowable CRC not calculated correctly).'"

Auditor Comment: At its request, we provided the Department with all information relating to our certified reasonable cost computation exceptions. In any case, the cited computation exceptions refer to the work of Department processors and not of its inspectors. Therefore, we find this comment puzzling.

Recommendations

The Department should:

8. Implement internal controls to ensure that required inspections are adequately conducted and supervised.

Department Response: "The Department has an effective system of internal controls in this regard and will continue to explore opportunities to further strengthen these practices."

Auditor Comment: Our audit found a lack of sufficient supervisory controls. Therefore, we encourage the Department to continue strengthening its inspection practices and to ensure that inspections are adequately conducted and supervised.

9. Instruct inspectors to identify and disqualify improperly installed work.

Department Response: "HPD inspectors are required to verify and identify all the work claimed by the applicant. The inspector's notes include a narrative as to whether the work is complete, incomplete or improperly installed. Improper or defective work is reported to and consulted with the supervisor before disqualifying the claim."

Auditor Comment: Obviously, Department inspectors did not identify improperly installed or defective work in the cases we cited in this report.

10. Ensure that inspectors have appropriate equipment for performing inspections.

Department Response: “Based upon each inspector’s knowledge and experience in doing J-51 inspections, the inspectors are provided with measuring tapes and wheels, flashlights, pen, paper etc. The inspector may be issued additional equipment to perform the inspection when deemed necessary by the supervisor.”

Auditor Comment: The Department inspector we accompanied and observed during the audit did not have appropriate equipment to carry out his assigned tasks. Therefore, the Department should do more to ensure that inspectors are provided with this equipment by, among other things, informing its inspectors that equipment can be obtained from the supervisor.

11. Adjust the certified reasonable costs for the cases cited in this report section and advise the Department of Finance about any changes that would affect J-51 benefits.

Department Response: “As stated in Response 6 above, HPD agrees to review the applications discussed in the auditors’ report. HPD will take appropriate action, as necessary, following its review.”

Other Issues

Problems with the Department’s J-51 Application Audits

According to procedures, the Department’s Management Review and Internal Compliance unit is required to audit J-51 applications with certified reasonable costs greater than \$100,000 and determine whether applicants paid appropriate filing fees and determine whether reasonable costs were properly computed. However, the Department did not audit any of the 16 applications (from our sample of 56) whose certified reasonable costs exceeded \$100,000, despite the fact that as of October 2005, 8 of the 16 applications were awarded certificates-of-eligibility more than one year before.⁹ According to Department officials, the audit workload consists of “any eligible J-51 cases awarded within the past two and ½ years.” Although there are no regulations or procedures requiring that audits be conducted within a specified timeframe, we believe this timeframe for review to be excessive. Establishing a shorter timeframe for reviewing applications is an important means of ensuring that the City quickly recoups any excessive tax benefits from applicants.

Our review of documentation for our additional sample of two applications (Docket Nos. 03/0133 and 03/0472) that were audited by the unit found no evidence that the auditors had verified that applicants had paid correct application filing fees.¹⁰ Moreover, auditors did not uncover an error in the computation of the certified reasonable cost for one sampled application

⁹ We obtained Department files for these applications in October 2005.

¹⁰Our own review verified that the fee computations were properly calculated.

(Docket No. 03/0133). It was not readily apparent whether the Department auditor did verify the certified reasonable cost computations on the J-2 form. Although the error we uncovered was minor, the cumulative effect of any such errors that are not identified by Department auditors may, in fact, be significant.

Furthermore, the Department does not have audit procedures to ascertain whether applicants submitted complete documentation in a timely manner. The Department did, however, fulfill its objective of auditing applicant payments to contractors to ascertain whether improvement costs were actually expended.

Recommendations

The Department should:

12. Ensure that Departmental auditors audit all J-51 applications with certified reasonable costs greater than \$100,000, in a timely manner.

Department Response: “HPD has done and will continue to do all audits within the time frame listed in the Retention of Books and Records section of the J-51 Rules and Regulations.”

Auditor Comment: The Department is incorrect in its contention that a timeframe for conducting audits is specified in the J-51 Rules. Section 5-07(b), “Retention of Books and Records,” does not indicate timeframes for conducting audits of J-51 applications. It merely describes the length of time that documentation must be retained by the applicant. Therefore, the Department should develop regulations or procedures that require audits to be conducted within a specified, meaningful timeframe.

13. The Department should develop sufficient procedures for auditing applications and train auditors in their use. In that regard, the Department should determine whether applicants paid appropriate filing fees and whether certified reasonable costs were properly computed.

Department Response: “HPD’s J-51 Audit Unit has procedures and utilizes an audit program which detail the steps taken during an audit, including verifying the accuracy and the validity of the certified reasonable costs.”

Auditor Comment: While the Department has an audit program that describes each step to be taken, our review indicated that there was no evidence that the program was applied consistently. Thus, in one case we found evidence of review by a Department auditor, while in another case there was no such evidence. In addition, there was no evidence to indicate that Departmental auditors verified that correct application filing fees were paid by applicants.

14. Audit applications for completeness and on-time submission.

Department Response: “HPD disagrees. The J-51 Audit Unit audits the J-51 benefit to ensure that the certified reasonable costs are verified and reasonable based on the Itemized Cost Breakdown Schedule.”

Auditor Comment: As stated in our recommendation, the Department’s audit unit should ensure that applications are eligible to receive benefits by auditing for completeness and on-time submission, in addition to ensuring that certified reasonable costs are verified and reasonable.

Discrepancies between the Rules and the Department’s Guidebook

The Department has not updated procedures outlined in its *J-51 Guidebook*, *Field Inspection Guide*, and form J-2’s “Itemized Schedule” so that they are consistent with the current Rules governing the program. Specifically:

- Items and allowances in the *Guidebook’s* “Itemized Breakdown Schedule” (i.e., item # 13, “General Construction,” and item # 4, “Electric”) are not consistent with those in the Rules.
- The *Guidebook’s* project category # 4 (“Substantial Rehabilitations of Formerly City-Owned Buildings”) does not list Class A buildings as being eligible under this category. In addition, it does not list “roofing” as a specified item under required “Building Systems” improvements.
- The *Field Inspection Guide’s* “Itemized Breakdown Schedule” does not include all items specified in the Rules (e.g., food waste disposer in “Plumbing” section, refuse recycling base and separating unit in the “General Construction” section, and various electrical service equipment in the “Electric” section). Furthermore, various item descriptions, units, and allowances are not consistent with those in the Rules.
- Form J-2’s “Itemized Schedule” includes two general construction items (i.e., “parapet only”; and “coping, no parapet”) that are not included in the “Itemized Breakdown Schedule” in the Rules.

Recommendation

15. The Department should revise its procedures to conform to the Rules.

Department Response: “HPD agrees to review the Guidebook to verify that it conforms to the rules.”

Exception Summary

Docket No.	Application Type	Documentation Exception (Required form(s) or document(s) missing or not properly completed) ¹	Timeframe Exception (Submission or work completed late) ¹	COE Issuance Exception (COE not issued as per Guidebook timeframe of 5 months or less after application completed)	CRC Computation Exception (total allowable CRC not calculated correctly)	Violation Search Fee Exception (search fee not charged when required)	Inspection Report Exception (no evidence of DACE inspection on file when claimed cost is over \$10,000)	Inspection Exception (Incorrect quantity or improper installation of work accepted by DACE inspector)	HPD Internal Audit Exception (not audited with CRC > or = \$100K)	Exception Details
01/0957	R								NA	
01/0973	R	X				X			NA	<u>Documentation Exception:</u> (1) CPA license number was not provided on form J-10B.2
01/1028	R		X			X		X	NA	<u>Timeframe Exception:</u> (1) Time between application submission and application completion exceeded maximum allowed.
01/1068	R		X			X	X		NA	<u>Timeframe Exception:</u> (1) Time between application submission and application completion exceeded maximum allowed. <u>Inspection Exception:</u> (1) Incorrect quantity for floor call station.
02/0350	R		X		UK	X			NA	<u>Timeframe Exception:</u> (1) Time between application submission and application completion exceeded maximum allowed. <u>CRC Computation Exception:</u> (1) Processor did not show any calculations on J-2 form.

Note:

1. 25 properties were issued certificates of eligibility that should not have been because of documentation and/or timeframe exceptions.

Legends:

Application Type

R = Regular
SF = Shortform
SL = Streamline

Coding

X = Exception
NA = Not Applicable
NA / I = Inspection conducted for claimed cost less than \$10,000
X / NA = Inspection Exception for Claimed Cost less than \$10,000 where DACE inspection was conducted.
UK = Unknown
UTI = Unable to inspect because audit team not granted access to property

Docket No.	Application Type	Documentation Exception (Required form(s) or document(s) missing or not properly completed) ¹	Timeframe Exception (Submission or work completed late) ¹	COE Issuance Exception (COE not issued as per Guidebook timeframe of 5 months or less after application completed)	CRC Computation Exception (total allowable CRC not calculated correctly)	Violation Search Fee Exception (search fee not charged when required)	Inspection Report Exception (no evidence of DACE inspection on file when claimed cost is over \$10,000)	Inspection Exception (Incorrect quantity or improper installation of work accepted by DACE inspector)	HPD Internal Audit Exception (not audited with CRC > or = \$100K)	Exception Details
02/0353	R				X		UTI	NA		
02/0523	R	X				NA / I	X / NA	NA		<u>Inspection Exception:</u> (1) Improper pointing. <u>Timeframe Exception:</u> (1) Time between application submission and application completion exceeded maximum allowed.
02/0614	R	X					X	X		<u>Documentation Exception:</u> (1) The construction completion dates are missing on J-2 form. (2) The violation search report is missing <u>Inspection Exception:</u> (1) Incorrect quantity for hollow metal doors.
02/0679	R	X	X		X	NA	NA	NA		<u>Documentation Exception:</u> (1) The J-8 form was missing. <u>Timeframe Exception:</u> (1) Time between application submission and application completion exceeded maximum allowed. <u>CRC Computation Exception:</u> (1) Did not apply decontrol reduction percentage.
02/0737	R			X	X			NA		<u>CRC Computation Exception:</u> (1) Processor improperly pro-rated total \$ for pointing on J-2.
02/0938	R		X					NA		
02/1013	R	X			X			NA		<u>Documentation Exception:</u> (1) The completion date of construction was missing for Boiler-burner on J-2 form.
02/1039	R				X			NA		
03/0045	R	X			X		X	NA		<u>Timeframe Exception:</u> (1) Time between construction start and application submission exceeded maximum allowed. <u>Inspection Exception:</u> (1) Incorrect quantity for floor call station.

Docket No.	Application Type	Documentation Exception (Required form(s) or document(s) missing or not properly completed)	Timeframe Exception (Submission or work completed late)	COE Issuance Exception (COE not issued as per Guidebook timeframe of 5 months or less after application)	CRC Computation Exception (total allowable CRC not calculated correctly)	Violation Search Fee Exception (search fee not charged when required)	Inspection Report Exception (no evidence of DACE inspection on file when claimed cost is over \$10,000)	Inspection Exception (incorrect quantity or work accepted by DACE inspector)	HPD Internal Audit Exception (not audited with CRC > or = \$100K)	Exception Details
03/0183	R			X	X			NA	CRC Computation Exception: (1) Processor improperly pro-rated total \$ for hollow metal doors on J-2.	
03/0323	R					X		NA		
03/0438	R			X	X		NA / I	NA	CRC Computation Exception: (1) Incorrect decontrol reduction percentage applied.	
03/0666	R	X				X		X	Documentation Exception: (1) J-2 was incomplete-dates were missing for completion of construction.	
03/0700	R			X	X			NA	CRC Computation Exception: (1) No reduction for non-residential space.	
03/0737	R	X		X				NA	Documentation Exception: (1) J-8 did not list the work for which the abatement was applied against. CRC Computation Exception: (1) Roof surface disallowed by processor with no supporting documentation.	
03/0753	R	X		X				NA	Documentation Exception: (1) J-8 form did not list the work for which the abatement was to be applied against. CRC Computation Exception: (1) Roof surface disallowed by processor with no supporting documentation.	
03/0811	R	X		UK	X	NA	NA	NA	Documentation Exception: (1) The signature on page 2 of J-5B form is different from the name on page 1. (2) Ownership section of Form J-5B not filled out. CRC Computation Exception: (1) Processor did not show any calculations on J-2 form.	
03/0824	R					X		NA		
03/0863	R			X	X			NA	CRC Computation Exception: (1) Did not apply de-control reduction percentage.	
03/0911	R							NA		
03/1021	R							NA		

Docket No.	Application Type	Documentation Exception (Required form(s) or document(s) missing or not properly completed) 1	Timeframe Exception (Submission or work completed late) 1	COE Issuance Exception (COE not issued as per Guidebook timeframe of 5 months or less after application completed)	CRC Computation Exception (total allowable CRC not calculated correctly)	Violation Search Fee Exception (search fee not charged when required)	Inspection Report Exception (no evidence of DACE inspection on file when claimed cost is over \$10,000)	Inspection Exception (Incorrect quantity or improper installation of work accepted by DACE inspector)	HPD Internal Audit Exception (not audited with CRC > or = \$100K)	Exception Details
03/1075	R		X		X			NA		
03/1088	R		X				X	X		<u>Inspection Exception:</u> (1) Incorrect capacity of oil tank allowed.
03/1172	R	X						NA		<u>Documentation Exception:</u> (1) Affidavit of replacement for the compactor was missing.
03/1257	R				X			NA		
03/1258	R	X			X			NA		<u>Documentation Exception:</u> (1) Owners list on J-5B is not filled out.
04/0012	R		X	UK				NA		<u>CRC Computation Exception:</u> (1) Processor did not show any calculations on J-2 form.
04/0261	R						X	X		<u>Inspection Exception:</u> (1) Incorrect quantity of windows allowed. (2) Improperly sized windows installation.
04/0307	R				X			NA		
04/0323	R	X			X		X	NA		<u>Documentation Exception:</u> (1) Form J-5A was used instead of J-5B. <u>Inspection Exception:</u> (1) Incorrect quantity of pointing allowed.
04/0347	R	X		X				X		<u>Documentation Exception:</u> (1) J-7B was missing. (2) Ownership section of Form J-5B was not completed.(Ownership % not listed) <u>CRC Computation Exception:</u> (1) Addition error in CRC total.
04/0453	R							NA		

Docket No.		Application Type	Documentation Exception (Required form(s) or document(s) missing or not properly completed) ¹	Timeframe Exception (Submission or work completed late) ¹	COE Issuance Exception (COE not issued as per Guidebook timeframe of 5 months or less after application completed)	CRC Computation Exception (total allowable CRC not calculated correctly)	Violation Search Fee Exception (search fee not charged when required)	Inspection Report Exception (no evidence of DACE inspection on file when claimed cost is over \$10,000)	Inspection Exception (Incorrect quantity or improper installation of work accepted by DACE inspector)	HPD Internal Audit Exception (not audited with CRC > or = \$100K)	Exception Details
04/0594	R	X				X			NA		<u>Documentation Exception:</u> (1) The completion date of construction was missing on form J-2.
04/0842	R	X				X			X		<u>Documentation Exception:</u> (1) The no. of apt before rehabilitation on J-1 form does not add up to 321. (2) No violation search report for 2630 Cropsy Ave in file.
04/0893	R				X		NA / I		NA		<u>CRC Computation Exception:</u> (1) Incorrect unit price used for apartment wiring only, adequate. (2) Incorrect item allowance for electric service equipment with individual meter.
04/0983	R							X	X		<u>Inspection Exception:</u> (1) Improperly installed roof work allowed.
04/0990	R						X	NA	X		
04/1035	R				X	X		X	X		<u>Inspection Exception:</u> (1) Incorrect quantity of ceramic tile allowed. <u>CRC Computation Exception:</u> (1) Did not apply de-control reduction percentage.
04/1162	R				X				X		<u>CRC Computation Exception:</u> (1) Processor improperly pro-rated elevator items on J-2.
04/1163	R	X				X			NA		<u>Documentation Exception:</u> (1) J-2 was incomplete-dates were missing for completion of construction of items.
04/1189	R	X				X			NA		<u>Documentation Exception:</u> (1) The completion dates of construction was missing on form J-2.

PHOTOGRAPHS OF UNSATISFACTORY WORK

Docket No. 02/0523, Photograph #1. Deteriorated and Poor Pointing Work



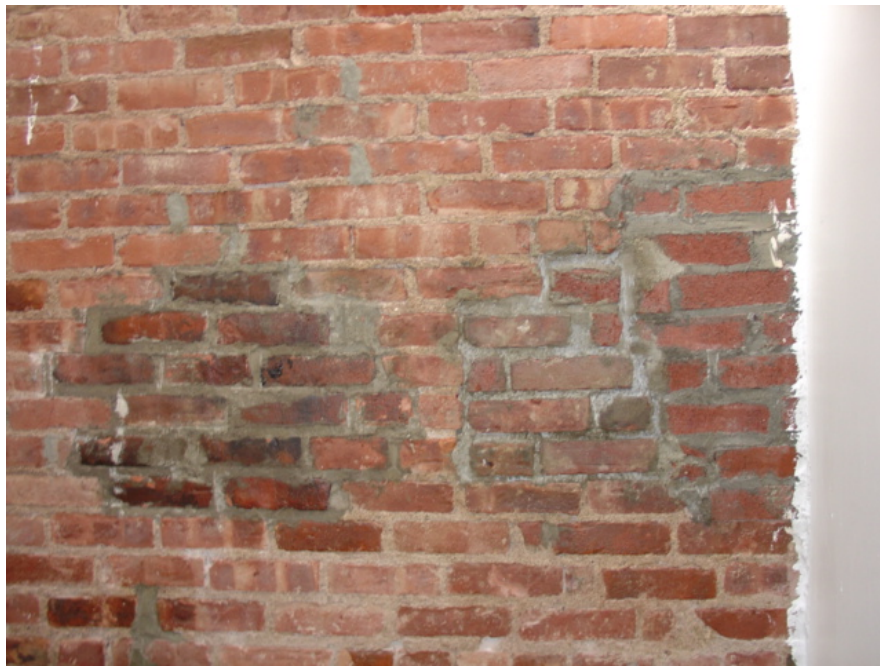
Docket No. 04/0983, Photograph #2. Poor Quality Roof (improper pitch)



Docket No. 04/0983, Photograph #3. Water Leakage through Roof



Docket No. 03/0426, Photograph #4. Interior Water Leakage





City of New York
DEPARTMENT OF
HOUSING PRESERVATION AND DEVELOPMENT
100 GOLD STREET, NEW YORK, N.Y. 10038

SHAUN DONOVAN
Commissioner

December 8, 2006

Mr. John Graham
Deputy Comptroller for Policy, Audits, Accountancy & Contracts
Office of the New York City Comptroller
1 Centre Street- Room 530 South
New York, New York 10007-2341

**Re: Audit on the Department of Housing Preservation and Development's
Administration of the J-51 Tax Incentive Program
Audit Number: FR06-067A**

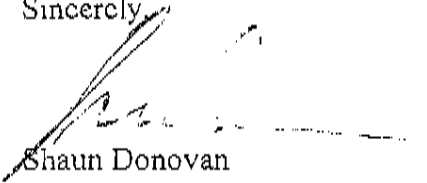
Dear Mr. Graham:

The following represents the Department of Housing Preservation and Development's response to the findings and recommendations made in your audit on the Administration of the J-51 Tax Incentive Program.

If you have any additional questions, please call Deputy Commissioner Bernard Schwarz at (212) 863-6610.

Thank you..

Sincerely,



Shaun Donovan



nyc.gov/hpd

HPD Response to Audit on Administration of the J-51 Tax Incentive Program
FR06-067A

Thank you for the opportunity to respond to the draft report on the Administration of the J-51 Tax Incentive Program. We are pleased with your determination that the sampled applications consisted of project types that qualified for inclusion in the J-51 program, and that applicants performed eligible work. However, for the reasons presented below, HPD disagrees with the auditors' conclusion that there are deficiencies in HPD's system of internal controls for administering the program. HPD disagrees with many of the exceptions noted by the auditors in their review of the agency's files. In some instances, the auditors appear to have overlooked documentation in the agency's records. In other instances, the auditors rejected HPD's explanations and interpretations of program rules and requirements, contrary to the application of these standards in accordance with past practices and legal determinations.

Documentation Exceptions

HPD disagrees with the documentation exceptions for 13 of the 18 files identified by the auditors. Of the 23 individual exceptions cited, HPD disagrees with 18.¹ On 3 of the exceptions with which we disagree, the auditors misinterpreted program requirements (03/0737, 03/753, 04/0323); on 3 other exceptions, the auditors incorrectly assume that Form J-5B was not properly completed by the applicant (03/0811, 03/1258, 04/0347); and on the remaining 12 exceptions, we disagree with the auditors' application of program rules and requirements in an overly technical manner.

On 6 of these 12 remaining exceptions, the auditors cited the applicant's failure to enter construction completion dates on Form J-2, the Itemized Schedule on which the applicant lists the quantities and costs claimed for eligible work (02/0614, 02/1013, 03/0666, 04/0594, 04/1163, 04/1189). An applicant's failure to provide construction completion dates on this form does not impede the processing of the application and is not a material omission. "Completion of construction" is defined in the J-51 rules (28 RCNY §5-02). For permitted work, the construction completion date is verified by the certificate of occupancy or Form J-3 issued by the Department of Buildings for work requiring a permit; alternatively, for non-permitted work, the construction completion date is verified by such information as HPD may require, including the work contract, invoices, and cancelled checks.

¹ On 2 of the exceptions cited, HPD agrees that Form J-8 is not in the application file (02/679, 04/1196). However, we believe that the form was received prior to issuance of the certificate of eligibility and has since been lost or misplaced. HPD observed, in preparing our responses to the preliminary and revised preliminary draft reports, that documents in the sampled files had been misfiled by the auditors, either because documents had been returned to the file out of the customary file order or placed in a file for a completely different application. For example, documents relating to 02/0679 were found in the file for 03/0438, and vice versa.

Of the other 6 exceptions, cited because a form was not completely filled out, the information was actually submitted elsewhere on the document or on another document in an alternate form (03/0811, 03/1172, 04/0347, 04/0842, 04/1196, 03/0426).

The following table outlines the Department's response to each documentation exception.

Docket #	Response to Documentation Exception	Agree	Disagree
01/0973	CPA license number was not provided on Form J-10B.2	X	
02/614	Construction completion dates missing from Form J-2 are inconsequential		X
	Certificate of occupancy issued more than one year after submission of the application (28 RCNY § 5-05(c)(6)(b)); therefore, HPD violation search report was required	X	
02/0679	Form J-8 not in file	X	
02/1013	Construction completion date missing from Form J-2 is inconsequential		X
03/0666	Construction completion dates missing from Form J-2 are inconsequential		X
03/0737	Form J-8 not required for a co-op; therefore, missing information on form was not material		X
03/0753	Form J-8 not required for a co-op; therefore, missing information on form was not material		X
03/0811	Signature on Form J-5B differed from printed name but conformed to other documents signed by owner		X
	No names listed on Schedule of Owners for Form J-5B – incorrect to assume that any individual holds greater than 10% share		X
03/1172	In lieu of an affidavit, HPD accepted contract signed by the parties, which specified “[r]emoval of the existing compactor from the premises,” and invoice for completed work, which stated “disconnected and removed old refuse compactor from premises”		X
03/1258	No names listed on Schedule of Owners for Form J-5B – incorrect to assume that any individual holds greater than 10% share		X
04/0323	Neither Form I-5A nor Form J-5B was required; the certified reasonable cost per dwelling unit was less than \$7,500 (28 RCNY § 5-03(h)(2))		X
04/0347	Missing Form J-7B – applicant submitted computerized rent roll with the required information instead		X
	No names listed on Schedule of Owners for Form J-5B – incorrect to assume that any individual holds greater than 10% share		X
04/0594	Construction completion date missing from Form J-2 is inconsequential.		X
04/0842	Sum of total number of apartments prior to rehabilitation was not calculated correctly by the applicant on Form J-1 – inconsequential because quantities for items claimed were not dependent on number of dwelling units		X
	HPD violation search report for second building not in file	X	
04/1163	Construction completion dates missing from Form J-2 are inconsequential		X
04/1189	Construction completion dates missing from Form J-2 are inconsequential.		X

04/1196	Missing Form J 7B - applicant submitted DHCR form with the required information instead		X
	Form J-8 not in file	X	
03/0426	Information missing from Affidavit and Certification section of DHCR Form RR-2S was contained elsewhere on the form and owner's signature was properly notarized		X

Timeframe Exceptions

HPD also disagrees with the timeframe exceptions for 7 of the 8 files identified by the auditors. On 2 of the 7 exceptions with which we disagree, the auditors apparently miscalculated the period between the construction start date and the filing of the application with HPD (03/0858, 99/0669);² and on the 5 remaining exceptions, the auditors misinterpreted program requirements or disagreed with longstanding policies and practices in HPD's administration of the program.

On 3 of the 5 remaining exceptions, HPD granted extensions of the 24-month deadline for completion of the application, because the Form J-3 issued by the Department of Buildings was not available (01/1028, 01/1068, 02/0523). The execution by the Department of Buildings of Form J-3 signifies that the permitted work was inspected and approved, that all required fees were paid, and that the building has no outstanding violations. Applicants are not penalized for delays in the issuance of the form. In addition, in the case of 02/0523, the processor requested additional documentation after the submission of Form J-3, to which the applicant promptly responded; therefore, it would have been inappropriate to charge the applicant for this subsequent delay resulting from the processor's review.³

In the case of the fourth remaining exception, the auditors based the construction start date on the first check paid on the contract, rather than on the second check (03/0045). According to industry custom, the first payment represents a deposit on the contract and the second payment is due at the actual start of work. In the case of the last remaining exception, the auditors misinterpreted the J-51 rules, which extends the deadline for completion of the application to the end of the tax quarter in which the 24th month falls (28 RCNY §5-03(d)(5)) (02/350).

The following table outlines the Department's response to each timeframe exception.

Docket #	Response to Timeframe Exception	Agree	Disagree
01/1028	Extension granted for submission of Form J-3		X
01/1068	Extension granted for submission of Form J-3		X
02/0350	Application was completed before end of quarter in which 24th month fell (28 RCNY §5-03(d)(5))		X

² 03/0858 and 99/0669 are 2 of the 3 exceptions that appear for the first time in the November 16th draft report. These 3 exceptions were not previously identified and the auditors have not provided HPD the details of the dates and documentation upon which they based their conclusions. Based upon HPD's review of the 03/858 and 99/0669 files, however, the applications were filed in a timely manner.

³ See also, footnote 2.

02/0523 NEW	Extension granted for submission of Form J-3; submission of affidavit of non-duplication was in response to processor's subsequent request		X
02/0679	Contractor's affirmation submitted more than 2 years after filing	X	
03/0045	Application was filed timely based on construction start date of 9/19/98, date of 2 nd check (memo on 1 st check stated "deposit roof" and contract confirmed that initial payment was due "at signing and acceptance of contract")		X
03/0858 NEW	Application was filed timely		X
99/0669 NEW	Applications for temporary and final certificates of eligibility were filed timely		X

Certificate of Eligibility Issuance Exceptions

HPD also disagrees with the auditors' decision to base exceptions on a non-existent deadline for a determination on eligibility 3 to 5 months from completion of the application. This timeframe is included in the J-51 Guidebook to provide applicants and owners new to the J-51 program with an estimated timeframe within which they can expect to receive a certificate of eligibility. The J-51 rules do not include a mandatory or suggested timeframe to complete the processing of an application. Individual applications may raise unique or complex issues which can extend the normal processing period.⁴

⁴ With respect to the file in which the auditors claim the certificate of eligibility was issued before the application was complete (03/1172), we note that Form J-3 for this application was signed by HPD and not the Department of Buildings, because the work claimed did not require permits (28 RCNY §5-05(c)(5)(iii, iv)). HPD's execution of Form J-3, although after issuance of the certificate of eligibility, was based upon a copy of the Department of Buildings' record received prior to issuance of the certificate of eligibility, which showed an absence of violations on the building.

The auditors also note that in 3 cases HPD conducted inspections of the claimed work after the applicants had submitted all required supporting documentation, suggesting that this may have delayed the processing of these applications. The auditors have not identified the 3 applications in their draft report. Previously, however, the auditors had identified 6 applications in which they claimed inspections were conducted after the applications were complete. Among the 6 applications previously identified, the Division of Architecture, Construction and Engineering's inspection report was returned an average of 8-9 weeks from the date requested by the Tax Incentive Programs unit. This average two-month period is a reasonable length of time given the need to schedule the inspection on a date convenient for both the inspector and the applicant, to conduct the inspection and any follow-up inspections required due to access or other problems, to draft the inspection report, and for supervisory review of the inspection results. The number of business days between the request and the report for the 6 applications ranged from 18 to 78. Without reviewing the circumstances of each of these applications, HPD nonetheless observed that in at least one of the cases, the inspection report may have been delayed because the claimed work had not been completed (the file indicates that the Department of Buildings' approval of the permitted work occurred after the date the J-51 application was filed with HPD and after the date the Tax Incentive Programs unit requested the inspection).

The following table summarizes the Department's position with respect to exceptions in this area.

Docket #	Response to COE Issuance Exceptions	Agree	Disagree
02/0938	Certificate of eligibility signed by end of quarter in which 5 th month fell		X
03/0438	Certificate of eligibility issued within 5 months from receipt of owner's letter on 5/21/04		X
03/1075	Certificate of eligibility issued more than 5 months from receipt of Forms J-5B and J-6 on 8/31/04		X
03/1088	Certificate of eligibility issued more than 5 months from receipt of Form J-3 on 5/18/04		X
04/0012	Certificate of eligibility issued within 5 months of receipt of Form J-3 on 2/19/04 and revised Inspection Report on 5/13/04		X

HPD is currently reviewing the process and workflow for receiving J-51 applications and determining eligibility and benefits, with the goal of improving upon the accuracy and efficiency of benefit determination. We are optimistic that the integration of computerized worksheets and other technological tools into current procedures will enable us to facilitate the processing of applications within the normal five-month timeframe, or perhaps to shorten it.

Calculation of Certified Reasonable Cost(CRC) and Fees

HPD disagrees with the calculation exceptions in 8 of the 12 files identified by the auditors. In the 4 cases in which there were errors in HPD's calculations, one resulted in a CRC that was \$300 too high and the others resulted in certified reasonable costs that were \$100, \$200, and \$1,300 too low. Thus, of the total certified reasonable costs of \$5,338,300 in the 56 applications reviewed by the auditors, HPD approved \$1,300 less in total certified reasonable costs than it should have, a margin of error of 0.024%, due to calculation error.⁵

As noted above, HPD is currently reviewing its procedures and exploring the use of computerized worksheets and other technological tools to enhance the accuracy and efficiency of the benefits determination process. HPD advised the auditors at the exit conference that a computerized spreadsheet was in the process of development that would increase the efficiency and accuracy with which certified reasonable cost calculations are performed. The computerized spreadsheet is currently in its final testing stages. Refer to the following table with respect to these exceptions.

⁵ The auditors claim that computation errors totaling an aggregate of \$34,450 (\$10,836 in overstated costs and \$23,614 in understated costs) were made in 12 of the 56 sampled applications. Although HPD disagrees with all but 4 of these exceptions, the total calculation errors claimed by the auditors would represent only a 0.65% margin of error from the total \$5,338,300 in certified reasonable costs associated with the 56 applications. Furthermore, the net financial significance of these errors to the City (\$12,778) would represent only a 0.24% margin of error. Therefore, even if all of the auditors' claimed computation exceptions were to be validated, they reflect a rate of error well below any conceivable expectation for a functioning government program.

Docket #	Response to Calculation Exceptions	Agree	Disagree
02/0679	Reduction not applied to superintendent's unit		X
02/0737	Allowed cost for pointing was \$100 too low	X	
03/0183	Hollow metal doors installed by two separate vendors, each for 2 doors; HPD allowed costs for doors installed by one of the vendors at owner's actual cost, and for the 2 remaining doors installed by the second vendor at the J-51 allowable cost		X
03/0438	Reduction not applied to superintendent's unit and owner-occupied unit		X
03/0700	Allowed cost for boiler-burner was \$300 too high	X	
03/0737	The J-51 history card for the premises and the J-51 computer database, which the processors review, indicated that prior benefits had been granted for roof surfacing		X
03/0753	The J-51 history card for the premises and the J-51 computer database, which the processors review, indicated that prior benefits had been granted for roof surfacing		X
03/0863	Reduction not applied to superintendent's unit		X
04/0347	Any calculation error did not affect amount of certified reasonable cost approved		X
04/0893	HPD calculated owner's claimed cost based on 7 apartments instead of 6 (Form J-2 claimed "6,7 [dwelling units]"; HPD used the more conservative figure)		X
	Allowed cost for electrical service equipment was \$1500 too low, resulting certified reasonable cost \$1300 too low	X	
04/1035	Reduction not applied to superintendent's unit		X
04/1162	Certified reasonable cost was \$200 too low	X	

The auditors claim that in 28 cases the Department did not charge applicants a \$30 processing fee to obtain a violation search report from HPD's Division of Code Enforcement (28 RCNY §5-05(f)(2)). Each of these applications contains a copy of the violation search report submitted by the applicant, frequently obtained through a private reporting service; therefore, no processing fee was required and none was charged. Since applications must include proof of compliance with the Housing Maintenance Code (28 RCNY §5-05(c)(6)), it is logical that applicants would prefer to obtain the search report independently, in order to correct any outstanding violations and to prepare the necessary proof of compliance. In any event, the J-51 staff now has the capacity to review violations online, and for applications received after December 30, 2004, violation search reports are no longer required to be submitted (28 RCNY §5-05(c)(6)(b)).

The auditors also claim that for 3 of the sampled applications, the processors did not record their computations on Form J-2 (02/0350, 03/0811, 04/0012). Based upon other documentation in the files, HPD is confident that the processors recorded their computations on Form J-2, that the computations were reviewed by the J-51 supervisors prior to issuance of the certificates of eligibility, and that the forms have since been lost or misplaced. See footnote 1, above, responding to documentation exceptions cited in the draft report.

Inspection Findings

We believe the photographs included in the report provide a misleading and inaccurate picture with respect to the quality of work at the time of completion. The work identified in each of the photographs was inspected following work completion several years ago. In most cases, the Comptroller's audit was conducted 2 to 3 years following the J-51 application review.

Appendix I of the auditors' report titled "Exception Summary" contains the following factual errors;

The coding "NA/I; Inspection conducted for claimed cost less than \$10,000.", as indicated in the legend at the bottom of the chart in the Inspection Report Exception was incorrectly applied for Docket numbers 02/0523 and 03/0438. Our review of these applications found they were submitted for over \$10,000. Therefore the required inspections were conducted and relevant reports filed.

The coding "X/NA; Inspection Exception for claimed cost less than \$10,000 where HPD inspection was conducted," as indicated in the legend at the bottom of the chart was incorrectly applied to docket no. 02/0523. Our review of this application revealed that the claimed cost was over \$10,000 and an inspection required by the regulations was conducted.

Several of the audited dockets state a finding of "Incorrect quantity or improper installation of work accepted by a Division of Architecture, Construction and Engineering (DACE) inspector."

HPD inspectors conduct inspections of all the claimed items. The Department's inspection is based upon visual observations and documents provided by the applicant. Where the quantities of our inspections differ from those provided by the applicant, it is our policy to allow the lesser quantity. We believe this policy prevents the approval of unsubstantiated work.

Regarding the issue of "improper installation of work," HPD believes this to be a time sensitive issue and maintains that at the time of the inspection, the observed work was properly installed. Additionally, we believe it stands to reason that the auditors' inspections, conducted approximately 2 to 4-1/2 years following completion of the work would in some cases result in a difference of interpretation of the quality of work.

DACE was not presented with an opportunity to review the inspection data relied on by the Comptroller's Office auditors which noted specific dockets as "CRC Computation Exceptions (total allowable CRC not calculated correctly)".

We therefore disagree with this conclusion by the auditors for 10 out of 11 docket numbers audited. We found the auditors were correct on docket number 02/0614, where the quantity of hollow metal doors was inaccurately calculated.

J-51 Application Audits

As stated in the audit report, the J-51 Audit Unit fulfills its objective of auditing applicant payments to contractors to ascertain whether improvement costs were actually expended. The Unit also reviews the calculation of the certified reasonable costs for each application they audit. If there are any issues with the calculation, the Unit Director will meet with the J-51 Program Director and the Inspection Supervisor to ensure a valid certified reasonable cost was determined.

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<u>Finding</u> Deficiencies in Reviewing and Approving Applications for Program Benefits	<u>Recommendation 1</u> HPD should ensure that appropriate Department staff is instructed in program policies and Rules. In that regard, Department staff should adhere to procedures for approving certificates of eligibility of payments by ensuring that applicants submit all required documentation and complete work within required time frames.	<u>Response 1</u> HPD disagrees that there are deficiencies in reviewing and approving applications. HPD does agree, however, and does ensure, that appropriate staff should be and are instructed in program policies and rules. New processors receive training on rules and procedures and are initially assigned less complex applications. All processors receive ongoing training both as a group and individually. The J-51 supervisors have created a reference manual for the processors' use and review every file before the Certificate of Eligibility is issued to ensure compliance with the Rules and Regulations.
<u>Finding</u> Problems with Reviewing and Processing Applications	<u>Recommendation 2</u> HPD should process applications and award certificates of eligibility within the Departments five month time frame.	<u>Response 2</u> HPD agrees that applications should be processed within five months of receipt of all required documentation. However, this five-month timeframe is a guideline which the J-51 program has established for itself and is not mandated by law or rule. Individual applications may raise unique or complex issues which may extend the normal processing period. Nevertheless, as evidenced by the auditors' findings and HPD's response, the five-month timeframe is in fact met for the vast majority of applications processed by HPD.
	<u>Recommendation 3</u> HPD should record and properly maintain all supporting documentation in Department files.	<u>Response 3</u> HPD agrees and does adequately ensure that all supporting documentation should be and is in fact recorded and properly maintained in Department files. All department files are reviewed by a J-51 supervisor prior to the granting of the benefits.
<u>Finding</u> Problems with Timeliness in Reviewing Applications	<u>Recommendation 4</u> HPD should ensure that work inspections are conducted promptly after applicants submit final applications.	<u>Response 4</u> HPD disagrees that there are problems with timeliness in reviewing applications. HPD agrees and does adequately ensure that inspections are conducted promptly after submission of final applications.



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<u>Finding</u> Problems with Calculating Certified Reasonable Cost and Fees	<u>Recommendation 5</u> The Program should computerize certified reasonable cost calculations.	<u>Response 5</u> HPD agrees that calculations of certified reasonable costs should be performed using a computerized program. However, as evidenced by the auditors' findings and HPD's response, HPD's calculations of certified reasonable costs are accurate, even without an automated spreadsheet. The J-51 Audit Unit is also responsible for verifying the amount of the calculations during their audits. HPD advised the auditors at the exit conference that a computerized spreadsheet that would increase the efficiency and accuracy with which these calculations are performed, was already in the process of development. The computerized spreadsheet is currently in its final testing stages.
	<u>Recommendation 6</u> HPD should review the applications discussed in this report to ensure their eligibility for J-51 benefits.	<u>Response 6</u> HPD agrees to review the applications discussed in the auditors' report.
<u>Finding</u> J-51 Improvements Funded by an Energy Conservation Grant	<u>Recommendation 7</u> HPD should consult with its general counsel to determine whether Program Rules should be revised to preclude applicants from obtaining J-51 benefits if they are obtaining – or have already obtained benefits for identical work from separate governmental entities.	<u>Response 7</u> HPD agrees to consult its general counsel regarding the possible revision of program rules to preclude applicants from obtaining J-51 benefits for work subsidized by other governmental entities. However, HPD notes that the state and local laws governing the J-51 program provide benefits for projects funded by energy conservation grants and other governmental loans, grants or subsidies. Therefore, the state and local legislatures have concluded as a matter of public policy that the granting of J-51 benefits to such projects is a worthy exercise of their constitutional tax abatement and exemption authority. HPD notes, from its experience in reviewing budgets for the development of these and other affordable



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housing projects, that larger government subsidies would be required if the projects were not eligible for tax benefits.

Finding

The Department is not ensuring that adequate work inspections are conducted

Recommendation 8

HPD should implement internal controls to ensure that required inspections are adequately conducted and supervised.

Response 8

The department has an effective system of internal controls in this regard and will continue to explore opportunities to further strengthen these practices.

Recommendation 9

HPD should instruct inspectors to identify and disqualify improperly installed work.

Response 9

HPD inspectors are required to verify and identify all the work claimed by the applicant. The inspector's notes include a narrative as to whether the work is complete, incomplete or improperly installed. Improper or defective work is reported to and consulted with the supervisor before disqualifying the claim.

Recommendation 10

HPD should ensure that inspectors have appropriate equipment for performing inspections.

Response 10

Based upon each inspector's knowledge and experience in doing J-51 inspections, the inspectors are provided with measuring tapes and wheels, flashlights, pen, paper etc. The inspector may be issued additional equipment to perform the inspection when deemed necessary by the supervisor.

Recommendation 11

HPD should adjust the certified reasonable costs for the cases cited in this report session, and advise the Department of Finance about any changes that

Response 11

As stated in Response 6 above, HPD agrees to review the applications discussed in the auditors' report. HPD will take appropriate action, as necessary, following its review.



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would affect J-51 benefits.

<u>Finding</u> Problems with the Department's J-51 Application Audits	<u>Recommendation 12</u> HPD should ensure that Departmental auditors audit all J-51 applications with certified reasonable costs greater than \$100,000, in a timely manner.	<u>Response 12</u> HPD has done and will <u>continue</u> to do all audits within the time frame listed in the Retention of Books and Records section of the J-51 Rules and Regulations.
	<u>Recommendation 13</u> HPD should develop sufficient procedures for auditing applications, and train auditors in their use. In that regard, HPD should determine whether the applicants paid appropriate filing fees and, whether certified reasonable costs were properly computed.	<u>Response 13</u> HPD's J-51 Audit Unit has procedures and utilizes an audit program which detail the steps taken during an audit, including verifying the accuracy and the validity of the certified reasonable costs.
	<u>Recommendation 14</u> HPD should audit applications for completeness and on-time submission.	<u>Recommendation 14</u> HPD disagrees. The J-51 Audit Unit audits the J-51 benefit to ensure that the certified reasonable costs are verified and reasonable based on the Itemized Cost Breakdown Schedule.
<u>Finding</u> Discrepancies between the Rules and the Guidebook.	<u>Recommendation 15</u> HPD should revise its procedures to conform to the Rules.	<u>Response 15</u> HPD agrees to review the Guidebook to verify that it conforms to the rules.

