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July 5, 2012

The Honorable David M. Frankel
Commissioner
Department of Finance
1 Centre Street, Room 500
New York, NY 10007

**Re: Letter Report on the Audit of the
Department of Finance's Administration of the
Real Property Income and Expense Statement Filing Process
(Audit Number FM12-064AL)**

Dear Commissioner Frankel:

We are sending this Letter Report to provide the results of the audit regarding the Department of Finance's (DOF) administration of the real property income and expense (RPIE) statement filing process. Our objective was to determine if DOF properly assesses penalties on improperly or untimely filed RPIE statements. In our opinion, DOF should improve its process for assessing penalties on RPIE statements that were filed improperly or untimely.

In October 2010, DOF assessed non-filers of the 2009 RPIE statement a penalty that amounted to significantly less than allowed under the law. According to Title 19 of the Rules of the City of New York (Section 33-03) and the New York City Administrative Code (Section 11-208.1), owners of income-producing properties who fail to file an RPIE statement shall be subject to a penalty not to exceed 3 percent of the property's final assessed value. The law provides for an increased penalty, not to exceed 5 percent of the property's assessed value, if the owner does not file the RPIE statement the following year (i.e., did not file for two consecutive years). On October 11, 2011, we wrote you a letter requesting that your office consider increasing the penalty DOF assessed property owners who failed to file an RPIE statement.

Although the filing requirement and penalty provision have been in the law for over 25 years, DOF did not actively pursue or impose any monetary penalty against property owners who failed to file the required RPIE statement until 2010. In October 2010, DOF began notifying non-filers that they would be assessed a penalty if they didn't comply with the filing requirements. However, DOF decided to impose a sliding scale penalty schedule, which is substantially less than the 3 percent prescribed under the law. For example, properties with an assessed value of between \$40,000 and \$749,999 were assessed a penalty of \$200 (rather than the \$1,200 to \$22,500 they could have been assessed if the 3 percent had been applied). This assessed value range includes over 91 percent of the 8,411 properties that DOF identified as non-filers. As a

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percentage of assessed value, the \$200 penalty represents .005 percent of the assessed value at \$40,000 and .000267 percent of the assessed value at \$749,999. This is a significant reduction from the 3 percent (of assessed value) non-filing penalty permitted by law.

In order to determine the potential effect of DOF's implementing a penalty that was less than what was allowed, we randomly selected 150 Class 4 properties (30 from each borough) whose owners, according to DOF, were required to-- but failed to-- file a 2009 RPIE statement. DOF assessed these properties an aggregate total of \$39,400 in penalties. Had these same properties been assessed at the 3 percent rate, the total penalty assessments would have been increased by over \$1 million.

After receiving our October 11, 2011, letter, your office partially implemented our recommendation and discontinued the sliding scale penalty schedule in favor of a penalty based on a fixed percentage of the property's assessed value. The penalty for 2010 non-filers was increased to .75 percent of the property's assessed value for first time non-filers and 1.5 percent for repeat non-filers. Although the penalty imposed will not be to the full extent allowed under the law, it is significantly greater than it was the previous year.

We now recommend that your office consider imposing the full 3 to 5 percent penalty allowed under the law against property owners who failed to file the required RPIE statement for 2011. After almost 25 years that a RPIE filing has been required, non-filers should be penalized to the fullest extent permitted by law. This would enhance DOF's efforts in obtaining property owners' compliance. Property owners who do not file the RPIE statement may be willing to incur a reduced penalty rather than provide DOF with reported income and expense data, which could result in an increase to the property's valuation and in the ensuing tax assessment that is far greater than the cost of a reduced penalty. Therefore, we believe that DOF should consider discontinuing the practice of offering discounted penalties for non-filers. For those property owners who continuously fail to file the RPIE statement, DOF should consider conducting audits to obtain the property's true income and expenses which would be used to properly assess the property's valuation and taxes.

Furthermore, we believe that DOF's list of property owners who potentially had to file an RPIE was not all inclusive. Although we made numerous requests and DOF officials promised on several occasions to provide a list of all owners of properties who might have to file, the list was never provided. Therefore, to test the completeness of DOF's database of property owners who may have to file an RPIE statement, without receiving a list from DOF, we compiled our own list of such properties. We combined several DOF-provided lists, such as: the list of non-filers, the list of property owners granted exemptions and exceptions from filing an RPIE, the lists of tax exempt property owners, and the list of property owners who filed an RPIE statement to create our own list of potential filers. When we compared our list of potential filers to a Department of Buildings list of properties which would meet the RPIE criteria, we found an additional 262 properties that were not on any of the lists that DOF provided.

The fact that DOF did not provide the requested list of potential filers is in itself an indication that DOF may be unaware of all properties that might be required to file an RPIE. This was confirmed when we found 262 additional properties not on any of DOF's listings. We

recommend that your office review existing procedures to ensure that all property owners who potentially have to file an RPIE statement are included on DOF's RPIE list. We also recommend that all future lists be maintained so that their completeness can be reviewed and used for subsequent years' analysis. On June 7, 2012, after the exit conference, DOF submitted the results of their follow-up on 158 of the 262 properties indicating that most of the 158 properties would be exempt or granted an exception (only granted for three years) from filing. These properties were not on the exemption or exception list DOF provided to us during the audit. If they had been we would have not requested DOF follow-up on the properties. Nevertheless DOF should follow-up on the remaining properties and either request they file an RPIE or add the properties to the exemption or exception list.

Lastly, it appears that DOF is not adequately monitoring the administration of the RPIE filing process. We requested basic statistical performance information for the 2009 and 2010 RPIE filing period on February 15, 2012. We followed up on the status of this request on several occasions. Each time, we were provided with a different explanation and told we would be receiving this information in a few weeks. Finally, on May 7, 2012, almost three months after our request, DOF forwarded some of the statistics requested.

DOF provided for 2009 and 2010 the number of RPIE statements filed by the due date, number of non-compliance notices mailed, and the number of RPIE statements filed during and after the allotted cure period. DOF still has not provided for 2010 the number of properties penalized for non-compliance and the date penalty posted to statement of account (this data was provided for 2009). This information is basic performance data that should be readily available for management review and should not have taken two and a half months to produce. Our review of the statistics provided leads us to question why there was a substantial increase of 22 percent from 2009 to 2010 in the number of properties that either filed RPIE statement or were mailed a non-compliance notice (owners of 77,501 properties either filed a 2009 RPIE or were mailed a non-compliance notice versus owners of 94,508 properties who either filed a 2010 RPIE or were mailed a non-compliance notice). This significant increase may indicate that the list of potential filers DOF provided for 2009 was not complete. We recommend that DOF maintain at least these basic statistics to be used by management for effective monitoring and tracking of property owner compliance.

Recommendations

We recommend that DOF should:

1. Consider imposing the full 3 to 5 percent penalty allowed under the law against property owners who failed to file the required RPIE statement for 2011.
2. Consider conducting audits for those property owners who continuously fail to file the RPIE statement to obtain the property's true income and expenses which would be used to properly assess the property's valuation and taxes.

3. Review existing procedures to ensure that all property owners who potentially have to file an RPIE statement are included on DOF's RPIE list of potential filers or the list of properties that have received an exemption or exception from filing. This review should include follow-up on the list of properties that we independently identified. We also recommend that all future lists be maintained so that their completeness can be reviewed and used for subsequent years' analysis.
4. Maintain ongoing and current statistics regarding the number of RPIE statements filed by the due date, number of non-compliance notices mailed, and the number of properties penalized for non-compliance. DOF management should use these to effectively monitor and track property owner compliance.

Audit Scope and Methodology

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

The audit covered the RPIE statement filings for tax years 2009 and 2010.

To gain an understanding of the policies and procedures that DOF has in place to ensure that property owners file RPIE statements, we conducted interviews with DOF officials and staff.

We reviewed Title 11, Chapter 2 § 11-208.1 of the Administrative Code of the City of New York and subdivisions §33-01 to §33-07 regarding filing of income and expense statements. In addition, we reviewed the RPIE Income and Expense Worksheet and Instructions. We used these documents as criteria to satisfy our objectives.

To date, DOF was unable to provide a list of potential RPIE filers for tax year 2009, which we requested on several occasions. In order to complete our review, we independently developed a list of potential RPIE filers for tax year 2009. We requested from DOB a list of properties that were identified as commercial properties or apartments or hotels and owners of these properties who might be required to file the RPIE statement. We compared that list of properties to the DOF lists of properties whose owners either filed a RPIE statement or were exempt from filing.

We then compared the properties that were on DOB files and not on any of the above lists to DOF's Assessment File and then to DOF's Address File to eliminate properties that would not be required to file an RPIE statement. According to DOF officials, RPIE statement filings are not required for Tax Class 1, Tax Class 2-capped, i.e. 2A, 2B, and 2C, and Tax Class 3 properties, and tax-exempt properties or any property that has a final actual assessed value of \$40,000 or less.

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We used DOF's New York City Automated Register Information System (ACRIS) to determine the tax class and final assessed value for the properties that were not on any of the DOF's files previously mentioned. In many cases, it was necessary to use the alternate Borough-Block and Lot (BBL) we obtained from the previous matches. After all the eliminations, there remained 262 properties that may require the owners to file an RPIE statement but were not on any of the lists provided by DOF.

Finally, we reviewed and compared the statistics that DOF provided on the administration of the RPIE program for 2009 and 2010.

On June 1, 2012, an exit conference was held and the preliminary letter report dated May 14, 2012 was discussed. Your June 28th response to our June 14, 2012, draft letter report is attached an addendum to this letter report.

You agree or partially agree with three of the four recommendations. Your partial disagreement with imposing the full penalty does not discuss that the penalty could have been imposed for the last 25 years and that DOF sent a letter to non-filers giving them a final chance to file the RPIE statement before imposing the penalty. We are still of the opinion that DOF provided non-filers ample warning and could have imposed the full penalty. Your disagreement with auditing those property owners who continuously fail to file the RPIE statement is due to your claim that DOF has more effective and less costly measures to address non-filers. If that is the case then DOF would not have had over 8,000 non-filers in 2009 since this filing has been a requirement for 25 years.

Sincerely yours,



Tina Kim

c: Celia Carino, Internal Audit Supervisor, Audit Liaison, DOF
Elizabeth Weinstein, Director, Mayor's Office of Operations
George Davis III, Deputy Director, Mayor's Office of Operations



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June 28, 2012

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Sent via e-mail: tkim@comptroller.nyc.gov

RE: Draft Letter Report on the Audit of the
Department of Finance's Administration of the
Real Property Income and Expense Statement Filing Process
(Audit #FM12-064AL)

Dear Deputy Comptroller Kim:

This letter serves as the Department of Finance ("DOF") response to the Comptroller's Draft Letter Report on the audit of DOF's administration of the Real Property Income and Expense Statement ("RPIE") filing process. The audit was focused specifically on DOF's assessment of penalties in connection with the 2009 RPIE, due in September 2010.

I. Background

Owners of income-producing properties are required to file RPIEs so as to ensure that DOF has accurate and complete income and expense information to use in the assessment of these properties. For the 2009 RPIE, DOF initiated a program to impose monetary penalties on non-filers, with the primary goal of increasing compliance with RPIE filing requirements. The initiative was highly successful, substantially raising the rate of RPIE compliance.

To implement the new penalty program, DOF put into place new noticing procedures and a hearing mechanism for those challenging charged penalties, so as to ensure that any penalties imposed would withstand judicial review. We have collected approximately \$2.7 million in RPIE penalties to date.

The Comptroller initiated an audit of the penalty program even before the first year of the program was completed. The program continues to evolve and improve in all respects, from record keeping, to administration, to implementation. We thank the Comptroller for the feedback in connection with this program.

II. DOF's Response to Recommendations

1. Consider imposing the full 3 to 5 percent penalty allowed under law against property owners who failed to file the required RPIE statement for 2011.

DOF partially agrees.

Each year DOF weighs a variety of factors in determining the penalty schedule. In our October 25, 2011 response to your October 11, 2011 letter to Commissioner Frankel, we offered a detailed description of numerous considerations that the agency weighed in determining penalty levels for the 2009 RPIE, and explained why it was inadvisable to impose the full amount allowed by law in the first year of the program. Ultimately, the Commissioner determined that our compliance goals and fairness concerns outweighed any incremental benefit that might be achieved by a higher penalty. Accordingly, for the first year of implementation, DOF imposed penalties using a fixed schedule based on a property's assessed value (e.g. properties with an assessed value of \$40,000 to \$749,000 paid a penalty of \$200; at \$750,000 to \$1.999 million the penalty increased to \$1,000, etc.). As it turned out, the majority of non-filers were smaller buildings, and thus the decision not to impose the maximum penalties proved to be rational and eminently fair.

For the second year of the penalty program, DOF increased the penalties significantly, based on a reweighing of several factors. The program was no longer new, and DOF could reasonably expect that property owners would be on notice of the penalties. On the other hand, a shift to penalties based on a percentage of assessed value results in some very high penalties that can be onerous and unfair when the failure to file is the result of mistake or inadvertence. Upon consideration of all the factors, DOF determined that penalties would be .75 percent of assessed value for first-time non-filers and 1.5% for repeat non-filers.

For future years, DOF will consider all relevant factors, including the results from prior years, to determine penalty levels. While the audit letter states in conclusory fashion that maximum penalties "would enhance DOF's efforts in obtaining property owners' compliance," we do not have any data to back up that statement. Specifically, we do not have data demonstrating that the higher penalties in the second year of the program increased the compliance rate above the successes achieved in the first year or that further increases in penalties would yield any additional improvement in compliance. The penalty levels that DOF establishes each year will be targeted to maximize compliance while being fair to property owners.

Finally, the audit letter suggests that maximum enhancement of penalties should be a goal of the program. We fundamentally disagree. While this Agency is the leading governmental instrumentality in demanding collection of all monies owed to the City, there are instances, such as this, where seeking maximum penalties serves no governmental purpose. In fact, it might lead to crushing certain small businesses for no apparent reason. We will not do that.

2. Consider conducting audits for those property owners who continuously fail to file the RPIE statement to obtain the property's true income and expenses which would be used to properly assess the property's valuation and taxes.

DOF disagrees.

DOF has more effective and less costly measures to address non-filers than the non-filer audit program recommended by this report. When owners do not file income and expense statements, assessors use comparable property information from multiple sources to determine the property's income and expenses for assessment purposes. It is in an owner's interest to file because failure to file has consequences to the owner in addition to monetary penalties. First, the property will be valued based on the assessor's determination of income and expense, which may result in a value that is higher than what the value would have been had they filed. Second, the owner will be barred from challenging the value determined by DOF at the Tax Commission and receiving a reduction based on Tax Commission review.

Accordingly, when an owner fails to file an RPIE, the agency is not without recourse. Assessors can use comparable information to determine income, and the owners are prohibited from challenging DOF's assessment at the Tax Commission. Given the other remedies available against non-filers, DOF's limited audit resources and the many high-priority audits requiring DOF attention, DOF does not intend to conduct audits of non-filers as a general rule.

- 3. Review existing procedures to ensure that all property owners who potentially have to file an RPIE statement are included on DOF's RPIE list of potential filers or the list of properties that have received an exemption or exception from filing. This review should include follow-up on the list of properties that we independently identified. We also recommend that all future lists be maintained so that their completeness can be reviewed and used for subsequent years' analysis.**

DOF agrees with this general statement but notes that the audit incorrectly labeled the majority of properties cited as having been required to file an RPIE.

We agree that DOF should ensure that our list of potential RPIE filers is complete and accurate. DOF reviewed the list of 262 properties identified by your audit. More than half (189) were not required to file or were not valued using the income approach. For example, 102 were co-op buildings for which no filing was required, 30 were properties valued on the cost approach for which income and expense information is not required, such as hospitals, asylums, nursing homes and adult care facilities and oil tanks, and 28 parcels were found not to exist.

Seventy-two properties remain which may have been misclassified. DOF is reviewing them further to determine their property tax classification and whether they should be filing RPIEs. Given that we have approximately 80,000 RPIE filers, the 72 missed filers represent a miniscule portion of the RPIE universe. We will continue to strive to have a list of required filers that is 100% accurate.

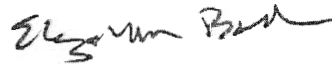
- 4. Maintain ongoing and current statistics regarding the number of RPIE statements filed by the due date, number of non-compliance notices mailed, and the number of properties penalized for non-compliance. DOF management should use these to effectively monitor and track property owner compliance.**

DOF agrees.

DOF agrees that maintaining accurate statistics and records is essential to effective administration of the RPIE penalty program. DOF is improving its systems that maintain the data as to the number of filers who file timely, the number of penalty notices sent, and the number for which penalties are paid.

Thank you for the opportunity to respond to your Draft Letter Report. If you have any questions concerning our response to your audit findings, please let us know. Please contact Celia Carino, Director of Internal Audit at (212) 669-4458 or by email at CarinoC@finance.nyc.gov.

Sincerely,



Elizabeth Botwin

EB:fr