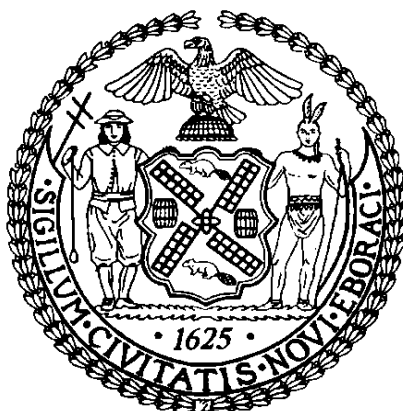


CITY OF NEW YORK OFFICE OF THE COMPTROLLER

**John C. Liu
COMPTROLLER**

FINANCIAL AUDIT

**H. Tina Kim
Deputy Comptroller for Audit**



**Audit Report on the Administration of the
Payments in Lieu of Taxes Program under the
New York City Department of Finance
July 1, 2006 to December 31, 2009**

FN10-085A

February 7, 2011



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

John C. Liu
COMPTROLLER

February 7, 2011

To the Residents of the City of New York:

My office has audited the Department of Finance's Administration of the Payments in Lieu of Taxes Program. We audit programs such as this as a means of ensuring that they are properly administered and in compliance with applicable agreements.

Payments in Lieu of Taxes (PILOTs) are established through agreements with property holders. Under the agreements, the City exempts the property holders from paying real property taxes and agrees to accept in lieu a prescribed amount, the PILOT, which is generally less than the real estate tax.

Our audit determined that DOF did not place 19 expired PILOTs back onto the City tax rolls in a timely manner. As a result, it failed to collect a total of \$785,730 in real property taxes. In addition, as noted in this report, DOF did not provide sufficient documentation that would allow us to ascertain whether DOF billed property owners accurately and in accordance with the terms of the active PILOT agreements.

The report recommended that DOF recoup \$785,730 in real property taxes due the City, immediately record expired PILOTs on the City property tax rolls, establish policies and procedures for payment calculations, bill property owners in accordance with the agreements, and facilitate information to ensure that audits conducted by the Comptroller's Office are properly completed as mandated by the City Charter.

The results of our audit, which are presented in this report, have been discussed with Department of Finance officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please email my audit bureau at audit@comptroller.nyc.gov.

Sincerely,



John C. Liu

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

**Audit Report on the Administration of the
Payments in Lieu of Taxes Program under the
New York City Department of Finance
July 1, 2006 to December 31, 2009**

FN10-085A

AUDIT REPORT IN BRIEF

Payments in lieu of taxes (PILOTs) are established through agreements with property holders. Under the agreements, New York City (City) exempts the property holders from paying real property taxes and agrees to accept in lieu a prescribed amount, the PILOT, which is generally less than the real estate tax.

According to a Memorandum of Understanding (MOU) among the New York City Economic Development Corporation (EDC), the Office of Management and Budget (OMB), the New York City Department of Finance (DOF), and the New York City Industrial Development Agency (IDA), DOF is responsible for administering the calculation and billings of PILOTs, based on the terms and the documents specified in the PILOT agreements. PILOT payments collected from property owners who have agreements with the IDA are deposited into an account maintained by an independent trustee (i.e., the Bank of New York).

When a PILOT agreement terminates, IDA issues a notification to DOF of the project expiration date via a Tax Directive Letter (TDL). The TDL indicates when a particular PILOT project should be removed from the PILOT program and placed onto the normal tax roll. This document is prepared by an attorney hired by EDC, and it serves as the basis for DOF to record the respective property on the City's property tax rolls to accordingly affect the levy of the real property tax.

Audit Findings and Conclusions

Our audit determined that DOF did not place 19 expired PILOTs back onto the City tax rolls in a timely manner. As a result, it failed to collect a total of \$785,730 in real property taxes. In addition, as noted in the scope limitation section of this report, DOF did not provide sufficient documentation that would allow us to ascertain whether DOF billed property owners accurately and in accordance with the terms of the active PILOT agreements.

Audit Recommendations

We make five recommendations to DOF based on our audit findings:

- Recoup a total of \$785,730 in real property taxes due the City.
- Ensure that properties whose PILOTs expire or that are no longer in the PILOT program be immediately recorded on the City property tax rolls.
- Establish policies and procedures for its payment calculations.
- Ensure that it accurately bills property owners for PILOTs in accordance with the terms of the agreements. In this regard, DOF should ensure that all calculations are reviewed and approved by the proper personnel.
- Facilitate the providing of information to ensure that audits conducted by the Comptroller's Office are properly completed as mandated by the City Charter.

Agency Response

In their response, dated December 8, 2010, DOF officials agreed with each of the five recommendations contained in the audit report and stated that "We have found the separate findings of your audit team to be helpful in re-organizing our PILOT unit's work." DOF officials also noted that DOF has made significant progress in reforming the work of the PILOT unit.

INTRODUCTION

Background

Payments in lieu of taxes are established through agreements with property holders. Under the agreements the City exempts the property holders from paying real property taxes and agrees to accept in lieu a prescribed amount, the PILOT, which is generally less than the real estate tax. The primary purpose of the PILOT program is to offer real property tax relief in the form of tax reduction to property owners seeking to remain, establish, or expand their businesses in New York City; provide subsidies for low income housing; and promote trade, industries, and commerce in the City in exchange for job creation and economic growth within the City.

PILOT payments are usually established at either a fixed amount based on the current real estate taxes paid on the underlying property the year before entering into the PILOT agreement, or on a formula that is based on the agreement. The components of the formula in a typical PILOT agreement would include the assessed value of the land and building, assessed value of capital improvements, property tax rates for real properties, PILOT commencement and termination dates, borough block and lot numbers, subtenant information, Industrial and Commercial Incentive Program (ICIP)¹ exemption information, building square footage, and number of employees.

According to a Memorandum of Understanding among the New York City Economic Development Corporation, the Office of Management and Budget, the New York City Department of Finance, and the New York City Industrial Development Agency, DOF is responsible for administering the calculation and billing of PILOTs, based on the terms and the documents specified in the PILOT agreements. PILOT payments collected from property owners who have agreements with the IDA are deposited into an account maintained by an independent trustee (i.e., the Bank of New York). According to the Local Law 73 of 2005, the trustee may disburse PILOT funds in the account for purposes agreed to by the Mayor and the City Council. The guidelines for granting and administering PILOT exemptions are governed by the uniform tax exemption policy requirements under the New York General Municipal Law.

When a PILOT agreement terminates, IDA issues a notification to DOF of the project expiration date via a Tax Directive Letter. The TDL indicates when a particular PILOT project should be removed from the PILOT program and placed onto the normal tax roll. This document is prepared by an attorney hired by EDC and it serves as the basis for DOF to record the respective property on the City's property tax rolls to accordingly affect the levy of the real property tax.

¹ The ICIP program has been replaced by the Industrial and Commercial Abatement Program (ICAP) in 2008.

Objectives

To determine whether DOF:

- bills property owners accurately for PILOTs in accordance with the terms of the agreements, and
- ensures that properties whose PILOTs expire are immediately recorded on the City's property tax rolls.

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives except for the scope limitation caused by DOF's failure to provide us with requested information, as disclosed in the subsequent paragraphs. This limitation prevented us from obtaining sufficient and appropriate evidence to determine whether DOF billed property owners accurately in accordance with the terms of the agreements. 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.

To conduct our audit of the administration of the payments in lieu of taxes program under the New York City Department of Finance, we requested specific data and detailed documentation to verify the accuracy of the PILOT payment calculations and billing practices for the audit scope period July 1, 2006, to December 31, 2009.

However, throughout the audit process, DOF caused extensive, delays, and provided limited information, which impaired our ability to perform sufficient audit steps that would allow us to properly quantify the PILOT amounts that may have been underpaid to the City.

When the audit was announced on September 16, 2009, DOF officials immediately requested a postponement. In their request, DOF officials stated that DOF was currently conducting an internal audit of the PILOT program and that opening an external audit of the same program at the same time would be disruptive. DOF officials further stated that they expected their internal audit to be completed by late November, at which point they would share the results with us. DOF officials however, never disclosed to us the results of their internal audit of the PILOT program.

Furthermore, DOF did not make it possible for us to start our audit until December 17, 2009 (three months after the audit was announced), and it was not until January 2010 that DOF provided us with some of the documentation we requested.

Furthermore, DOF did not provide key documentation to allow us to complete our analysis of the PILOT calculations and billing practices. For example, DOF did not provide the following:

1. Documentation that would support the structure for calculating PILOT payments in accordance with the terms of the agreements, such as:
 - permit issuance date, which would determine the PILOT commencement date;
 - ICIP exemption;
 - capital improvement information;
 - subtenant information;
 - building square footage information;
 - number of the employees of respective PILOT recipients;
 - additional production facility expansion costs incurred, Sales Tax Benefit already received, and realized aggregate real estate tax savings.
2. Notification to PILOT participants to determine whether or not subsequent capital improvements should be qualified for any abatement or exemption;
3. Supporting documentation related to DOF's PILOT calculations and billing, including:
 - discrepancies in the opening and closing balances of consecutive billings;
 - delay in PILOT start dates;
 - the formula, exemption base, allocation of land tax abatement among various lots, and the adjustments that were not specified in the PILOT agreements but were applied by DOF.

Due to the lack of sufficient documentation, we were not able to quantify the potential discrepancy, if any, between the amounts DOF calculated and the amounts that should have been billed PILOT to recipients based on their agreements.

As previously noted, DOF officials never disclosed to us the results of their own review of the PILOT program. Instead, they hired an outside CPA firm to initiate an independent review of the PILOT program that would address the same objectives of our PILOT audit. As a result, we decided to discontinue our review and to report and comment on the issues already identified and the scope limitation imposed by DOF.

The scope of this audit covered the period July 1, 2006, through December 31, 2009. To obtain an understanding of DOF's administration of the PILOT program, we reviewed and abstracted the Memorandum of Understanding as of July 1, 1992, among IDA, EDC, DOF, and OMB. We reviewed the lists of IDA and non-IDA active and expired PILOT projects, the tracking sheets of the IDA PILOT billing and payment details, and the bank statements of the IDA PILOT Trust account. To familiarize ourselves with the operation of the PILOT program, we interviewed DOF, IDA, and EDC officials and conducted a walk-through of the billing process. We documented our understanding of DOF's administration of the PILOT program and its internal control processes through flowcharts and written narratives.

We did not test the reliability of the data processed by DOF's IT systems. Our test of the PILOT data was based on the information provided in the agreements and whether that information was accurately reflected in DOF's billing records.

To ascertain the number of PILOT projects that were active and expired during our audit scope period, we reconciled the lists of PILOT projects independently provided by IDA, EDC, and DOF. Based on these lists, we developed a spreadsheet to include all PILOT accounts reported, and we summarized the total PILOT amounts billed for all PILOT projects during our scope period.

For our preliminary review, we judgmentally selected 29 IDA (11.1% of 261) and all 23 non-IDA projects that were active as of December 31, 2009. For each of the items in our sample, we reviewed the PILOT-related documentation and recalculated the PILOT amounts for the period July 1, 2006, through December 31, 2009, as a basis for our detailed testing. Specifically, we reviewed the PILOT agreements, DOF's billing and payment records, historical assessed values of the land, building, and capital improvements retrieved from DOF's Real Property Assessment Database (RPAD), and the permit issuance information obtained from the Web site of the New York City Department of Buildings. We then formulated a methodology for recalculating these payments based on the criteria of the PILOT agreements, and we compared the resulting amounts to those on the billing and payment records provided by DOF for accuracy and consistency.

To determine whether DOF placed the properties of the expired PILOTs back on the City tax rolls in a timely manner, we identified the effective PILOT expiration dates noted in IDA's TDL for each project that expired during the period July 1, 2006, through December 31, 2009, and we then compared it with the tax period that the properties were first billed for regular real estate tax, as recorded in DOF's Web site. We then calculated the property tax due the City by multiplying the prevailing property tax rate with the lower of the combined Actual Assessed Value and Transitional Assessed Value on land and buildings as these values appear in DOF's Web site, for the number of tax periods that the revenue was uncollected.

Discussion of Audit Results

The matters covered in this report were discussed with DOF officials during and at the conclusion of this audit. A preliminary draft report was sent to DOF officials and discussed at an exit conference held on September 14, 2010. At the exit conference, we received additional information regarding the issues addressed in the preliminary report. We reviewed the additional information provided by DOF officials and revised our preliminary report accordingly. Those revisions were reflected in our draft report, which was submitted to DOF officials on November 23, 2010, with a request for comments. We received written responses from DOF on December 8, 2010. In their response, DOF officials agreed with each of the five recommendations contained in the audit report and stated that "We have found the separate findings of your audit team to be helpful in re-organizing our PILOT unit's work." DOF officials also noted that DOF has made significant progress in reforming the work of the PILOT unit.

FINDINGS

Our review determined that DOF did not place 19 expired PILOTs back onto the City tax rolls in a timely manner. As a result, it failed to collect a total of \$785,730 in real property taxes. In addition, as noted in the scope limitation section of this report, DOF did not provide sufficient documentation that would allow us to ascertain whether DOF billed property owners accurately and in accordance with the terms of the active PILOT agreements.

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

DOF Failed to Collect \$785,730 in Real Property Taxes

Our analysis of all 54 PILOT projects that expired from July 1, 2006 through December 31, 2009 noted that DOF did not place 19 projects back on the regular City tax rolls in a timely manner. As a result, the City did not collect a total of \$785,730 in unbilled property tax revenue, as detailed in the appendix.

When a PILOT expires, IDA issues a notification to DOF of the project expiration date via a Tax Directive Letter (TDL). This notification is prepared by an attorney indicating when a particular project should be removed from the PILOT program and placed into the normal tax roll. Accordingly, the TDL then serves as the basis for DOF to record the respective property on the City's property tax rolls to affect the levy of the real property tax. However, our review of the 54 PILOT projects noted that 19 of these projects were not returned to the City tax rolls in a timely manner, and three of them were still not billed as of December 31, 2009.

We identified the PILOT project retirement dates indicated in the TDL and compared them to DOF's account history report. We then calculated the property tax due the City by multiplying the prevailing property tax rate with the lower of the combined Actual Assessed Value and Transitional Assessed Value on land and buildings, as they appear in DOF's Web site, by the number of tax periods for which the revenue was uncollected. Our calculation also considered DOF's deduction for any applicable exemption and abatement. Based on this calculation, we determined that DOF did not collect a total of \$785,730 in property tax revenue.

Deficiencies in DOF's Internal Controls Over Its Administration of the PILOT Program

Our review revealed various control weaknesses in DOF's administration of the PILOT program. For example, DOF did not maintain adequate records supporting its PILOT payment calculations and billing practices. In addition, DOF did not have policy and procedure manuals documenting the criteria and guidelines to be followed for the PILOT calculation. DOF did not have proper levels of review to ensure that the PILOT calculations were accurate and reliable. Based on our limited review, we noted that DOF did not include certain key provisions in their calculations. For example, DOF failed to include PILOT project's employee data in their

calculation, and did not take into consideration the additional capital improvements that would determine the true assessed value for the purpose of PILOT calculations.

Other Issue

In January 2010, while our audit was in progress, DOF retained a CPA firm to perform a similar review of the PILOT program going back to 2002, for which it incurred possibly unnecessary consulting expenses. In addition, we question the inclusion of 2002 and 2003 in the scope period of their review since under statutory time limits DOF cannot recoup any past due PILOT amounts prior to 2004. In this regard, DOF clearly did not exercise proper due diligence and as a result, it incurred unnecessary excessive fees for extending the scope of the CPA firm's review over a two-year period.

In addition, our review of the information related to the CPA's report received on July 21, 2010, revealed the following for our scope period July 1, 2006, through December 31, 2009:

- The report did not include at least 35 PILOT projects that were either active or terminated from 2002 through 2010. Those included at least 9 active IDA projects, 2 active Non-IDA projects, and 24 expired IDA projects.
- The report understated \$68,819 in its Notice of Calculation issued for a property in Queens, block 4282, lot 100. Nevertheless, DOF subsequently recognized the understatement and revised its billing on August 4, 2010.

Given the errors previously discussed and DOF's inadequate billing records, we are unsure whether DOF provided the CPA firm with sufficient and accurate information as a basis for their external review.

RECOMMENDATIONS

We recommend that DOF:

1. Recoup a total of \$785,730 in real property taxes due the City.

DOF Response: “Finance agrees. All the amounts that the Comptroller has identified have been billed, and are due at the next semi-annual payment date of January 1, 2011.”

2. Ensure that properties whose PILOTs expire or that are no longer in the PILOT program be immediately recorded on the City property tax rolls.

DOF Response: “Finance agrees. All properties with PILOTs are restored to the tax rolls retroactive to the date of the PILOT termination date as soon as we receive a notice of the PILOT’s termination. In addition, the PILOT unit tracks PILOT end dates on a spreadsheet and this information will be made part of a PILOT database when one is developed.”

3. Establish policies and procedures for its payment calculations.

DOF Response: “Finance agrees. The PILOT unit is now in the process of establishing a written policy and procedure manual.”

4. Ensure that it accurately bills property owners for PILOTs in accordance with the terms of the agreements. In this regard, DOF should ensure that all calculations are reviewed and approved by the proper personnel.

DOF Response: “Finance agrees. We have already instituted this change. As your auditors are aware from meetings with staff, DOF has assigned a new PILOT supervisor. In addition, PILOT calculations are disclosed to property owners through the Notice of Calculation, and sent to EDC for all IDA PILOTs.”

5. Facilitate the providing of information to ensure that audits conducted by the Comptroller’s Office are properly completed as mandated by the City Charter.

DOF Response: “Finance agrees. As we noted earlier, this audit did not meet our high standards of cooperation. DOF did not have much of the requested information listed, but we failed to respond to your audit staff to explain that the information did not exist. We also did not show the auditors how to find some of the information on-line through Finance’s systems.”

APPENDIX

[illegible]



David M. Frankel
Commissioner

Elizabeth D. Botwin
Deputy Commissioner
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December 8, 2010

Tina Kim
Deputy Comptroller for Audit
Office of the City Comptroller
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Via e-mail: tkim@comptroller.nyc.gov

Re: Audit Report on the Administration of the Payments in Lieu of Taxes Program under the New York City Department of Finance, July 1, 2006 to December 31, 2009 (FN10-085A)

Dear Ms. Kim:

This letter serves as the Department of Finance's response to the above audit, dated November 23, 2010, addressing the administration of the Payments in Lieu of Taxes (PILOT) Program. Before addressing each of the five recommendations contained in the audit, let me first thank you for this opportunity to respond.

I also want to acknowledge the unusual circumstances that your auditors faced in the course of this audit. Finance started an internal audit of the PILOT unit's operations in the summer of 2009. When we received your audit engagement letter in September, we asked you to postpone the start of your audit by several months to allow us to do that review and you agreed. We were grateful for your cooperation. Our internal audit turned up systemic issues and we concluded that the PILOT unit needed a complete overhaul. To assist us, Finance engaged KPMG to help review the PILOT agreements, determine the appropriate amount to bill, calculate past under and over-billing, and suggest how to update business practices.

Unfortunately, having multiple in-depth reviews focusing on the PILOT unit led to failures of cooperation with the Comptroller's Office. Commissioner Frankel has repeatedly instructed that Finance staff fully and openly cooperate with all external auditors, including specifically the Comptroller, and we will make certain to comply with that direction in the future.

Substantively, we have made tremendous progress in reforming the work of our PILOT unit. We have established a Notice of Calculation for all PILOT

payers to explain with clarity and transparency how the PILOT payments were calculated. With the help of KPMG, most of the City's PILOT agreements have been reviewed to determine the correct payment and we are correcting past billing errors. We determined that \$13.4 million in PILOT payments were not billed. We have notified the property owners and have already collected \$11.4 million. We have also determined that \$6.6 million in PILOT payments were overbilled, for which \$1.3 million in credits have been issued to date. We have also established firmer protocols governing PILOTs with EDC.

We have found the separate findings of your audit team to be helpful in re-organizing our PILOT unit's work. As you will note in our responses to the recommendations below, your findings will end up further strengthening the work of Finance's PILOT unit.

Recommendations

- 1. Recoup a total of \$785,730 in real property taxes due the City.**
Finance agrees

All the amounts that the Comptroller has identified have been billed, and are due at the next semi-annual payment date of January 1, 2011.

- 2. Ensure that properties whose PILOTs expire or that are no longer in the PILOT program be immediately recorded on the City property tax rolls.**
Finance agrees.

All properties with PILOTs are restored to the tax rolls retroactive to the date of the PILOT termination date as soon as we receive a notice of the PILOT's termination. In addition, the PILOT unit tracks PILOT end dates on a spreadsheet and this information will be made part of a PILOT database when one is developed.

- 3. Establish policies and procedures for its payment calculations.**
Finance agrees.

The PILOT unit is now in the process of establishing a written policy and procedure manual.

- 4. Ensure that [Finance] accurately bills property owners for PILOTs in accordance with the terms of the agreements. In this regard, DOF should ensure that all calculations are reviewed and approved by the proper personnel.**
Finance agrees.

We have already instituted this change. As your auditors are aware from meetings with staff, DOF has assigned a new PILOT supervisor. In addition, PILOT calculations are disclosed to property owners through the Notice of Calculation, and sent to EDC for all IDA PILOTs.

5. **Facilitate the providing of information to ensure that audits conducted by the Comptroller's Office are properly completed as mandated by the City Charter.**

Finance agrees.

As we noted earlier, this audit did not meet our high standards of cooperation. DOF did not have much of the requested information listed, but we failed to respond to your audit staff to explain that the information did not exist. We also did not show the auditors how to find some of the information on-line through Finance's systems.

Once again, we are grateful for the professionalism that you and your staff brought to this particular audit. Thank you, and please get back to me if you have any further questions regarding this response.

Sincerely,



Elizabeth Botwin

- C: David M. Frankel, Commissioner
Andrew Salkin, Deputy Commissioner, Operations
Beth Goldman, Deputy Commissioner, Legal Affairs
Leslie Zimmerman, Assistant Commissioner, Payment Operations
Christopher Browne, Assistant Commissioner, Communications and Government Affairs
Sara Meyers, Director of Operations
John Ravalli, Internal Audit Supervisor
George Davis III, Mayor's Office of Operations