AUDIT REPORT

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

Audit Report on Department of Finance Oversight of the Industrial and Commercial Incentive Program

FR03-181A

June 30, 2005

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:

Pursuant to Chapter 5, Section 93 of the New York City Charter, we have examined whether the Department of Finance is properly reviewing and approving applications for tax benefits under the Industrial and Commercial Incentive Program, and ensuring that applicants remain eligible for benefits. The results of our audit, which are presented in this report, have been discussed with agency officials, and their comments have been considered in preparing this report.

Audits such as this provide a means of ensuring that programs that provide tax benefits are being administered in accordance with applicable laws and regulations.

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

Very truly yours,

William C. Thompson

William C. Thompson, Jr.

WCT/gr

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

Audit Report on Department of Finance Oversight of the Industrial and Commercial Incentive Program

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AUDIT REPORT IN BRIEF

We performed an audit of the Department of Finance's (Department) oversight of the Industrial and Commercial Incentive Program. The program was created by Local Law 71 on November 5, 1984, as authorized by the New York State Real Property Tax Law (Title 2-D). Under the program, the Department offers property tax exemptions and abatements to qualified property owners. A tax exemption is a reduction in the assessed value of a property; an abatement is a credit against the tax due. According to the Rules of the City of New York (Rules), to obtain an exemption or abatement, applicants must perform eligible construction work by making permanent capital improvements that create or enhance the value of a property. In addition, applicants must, within specific time periods, make a "minimum required expenditure" in carrying out the eligible improvements.

Audit Findings and Conclusions

The Department properly calculates the amount of individual exemptions. However, there are significant weaknesses in the administration of the program. Specifically, the Department does not have adequate internal controls to ensure that it properly reviews and approves applications for program exemptions and abatements and does so in a timely manner. As a result, the Department approved applications for applicants who did not adhere to the Rules governing the program. Applicants did not submit documentation when required, and Department files did not contain all necessary documentation to indicate whether applicants had fulfilled various program requirements. In addition, the Department improperly granted certificates-of-eligibility to owners of 11 of the 66 applications reviewed. Additionally, the Department does not have adequate procedures to complete inspections in a timely manner to ensure that improvement work does not start before an applicant submits a preliminary application.

Moreover, the Department does not effectively administer the program to ensure on an annual basis that applicants remain eligible for program benefits. The Department did not suspend or adjust program benefits for properties whose use changed, thereby becoming

ineligible for benefits. In addition, if the Department allows these properties to remain in the program, the City will forgo taxes on these properties in future years. Finally, the Department did not suspend program benefits for properties for which required certifications of continuing use were not submitted. As a result of these weaknesses, the City failed to collect $2,527,013 for the properties in our sample, and will forgo in future years tax revenue totaling at least $1,429,998.

Finally, the Department databases containing information about program applications are unreliable.

Audit Recommendations

This report makes a total of 20 recommendations. The major recommendations are as follows:

The Department should:

- Prepare formal written policies and procedures that comply with program Rules that cover program guidelines, that stipulate timetables for reviewing applications, and that levy penalties for failure to submit documentation.

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

- Enforce the provisions of the Rules governing the program on a consistent basis.

- Ensure that only improvement work eligible under the Rules be qualified to fulfill minimum required expenditure amounts; and assign and instruct appropriate personnel to review and analyze work descriptions in applications to determine whether work is eligible for program benefits.

- Ensure that certificates are submitted annually for all properties. In the event that certificates are not submitted, the Department should suspend program benefits for those properties.

- Conduct a thorough review of an applicant's certificate-of-continuing-use, the inspection report, and other supporting documentation to determine whether a property remains eligible for program benefits.

- Conduct inspections of properties receiving ongoing benefits to verify that the property's use has not been converted to an ineligible use. Suspend or revoke benefits to properties that do not comply with program requirements regarding continuing use.

- Establish procedures to effectively administer the program and ensure that applicants are entitled to continue receiving program benefits.

- Suspend or revoke benefits when property owners do not comply with continuing-use requirements.

INTRODUCTION

Background

The Department of Finance (Department) administers and enforces the tax laws; collects taxes, judgments, and other charges; educates the public about its rights and responsibilities with regard to taxes and tax benefit programs in order to achieve the highest level of voluntary compliance; provides service to the public by assisting in customer problem resolution; and protects the confidentiality of tax returns. The Department processes parking summonses and provides an adjudicative forum for motorists who wish to contest them. The Department also provides collection enforcement services for court-ordered private and public sector debt.

The Department offers property tax exemptions and abatements to qualified property owners under the Industrial and Commercial Incentive Program (program). The program was created by Local Law 71 on November 5, 1984, under legislation authorized by the New York State Real Property Tax Law (Title 2-D). The program initially offered solely tax exemptions for capital improvements made by qualified owners of industrial and commercial properties. However, the legislation was amended in 1995 to also include tax abatements for industrial properties.

In Fiscal Year 2004, the program provided $314 million in real estate tax exemptions and abatements to owners of industrial or commercial buildings. A tax exemption is a reduction in the assessed value of a property; an abatement is a credit against the tax due. Exemptions are granted on a sliding scale for periods of up to 25 years, based on the type and location of the improvement. Abatements are also granted on a sliding scale for a maximum period of 12 years.

According to Chapter 14, Title 19, of the Rules of the City of New York (Rules), to obtain an exemption or abatement, applicants must perform eligible construction work by making permanent capital improvements that create or enhance the value of a property. In addition, applicants must, within specific time periods, make a "minimum required expenditure" on the eligible improvements. The minimum required expenditure is a percentage of a property's assessed value before improvement—either 10 or 20 percent for exemptions (depending on where the property is located), and 25 percent for abatements.

Participation in the program requires an applicant to file two separate applications with the Department's Exemptions Unit—a preliminary application before obtaining a building permit or before commencing construction if no permit is required, and a final application within 30 days after beginning construction. The Exemptions Unit typically reviews the preliminary application within 20 days of receipt and determines whether the applicant is eligible to participate in the program. If the applicant is deemed eligible by the Exemptions Unit, assessors of the Property Tax Unit must, within two weeks, conduct a preliminary inspection of the property to confirm that improvement work has not started and notify the Exemptions Unit. At

least 15 days before beginning construction, applicants must notify the Exemptions Unit in writing of the starting date. The applicant then files a final application within 30 days after starting construction. After the Exemptions Unit receives and reviews an applicant's final application and deems it satisfactory, the Department issues a preliminary certificate-of-eligibility.

While construction of projects costing more than $1 million is under way, the applicants must file biannual interim construction reports with the Department. All applicants must submit documentation to substantiate that the minimum required expenditure has been met. Department assessors conduct annual inspections of a property to determine whether the property's assessed value has increased. These inspections must be completed by January 5. Within 15 days of the completion of the improvements, an applicant must notify the Department of the completion and must submit a final construction report within 60 days of completion. Once an applicant has completed these steps, the Department issues a final certificate-of-eligibility, which is recorded in the *City Register*. However, according to §14-10 of the Rules, for an applicant to in fact receive an exemption or an abatement, the eligible construction work would have to enhance the value of the property.

To obtain benefits in successive years, applicants must file with the Department annual certificates-of-continuing-use, which must indicate the property's current use(s). The Department must review the use(s) of the property and determine whether an applicant is still eligible for the program benefits that the property is receiving.

Objective

Our audit objectives were to determine whether the Department properly reviews and approves applications for program exemptions and abatements; whether the program is administered to ensure that applicants remain eligible for program benefits; and whether exemptions are properly calculated. During fieldwork we determined that one issue—the granting of abatements, one part of the foregoing objectives—was so significant as to warrant issuance of a report (Audit No. FR03-169A) devoted solely to that subject. The present report covers the other issues related to our audit objectives.

Scope and Methodology

The scope of this audit covered projects in the Industrial and Commercial Incentive Program for which preliminary and final certificates-of-eligibility were issued by the Department in Fiscal Years 2002 and 2003; and for which final certificates-of-eligibility were issued by the Department before Fiscal Year 2002 and which were still receiving program benefits in Fiscal Year 2004. We obtained from the Department personal-computer and mainframe databases of these projects and their associated properties indicating key steps in the Exemption Unit's review process and benefits received. For these databases, we conducted data reliability testing for data integrity, completeness, and accuracy.

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

To determine whether the Department properly reviews and approves applications for program exemptions and abatements, we reviewed the entire population of 66 applications for which the Department issued both preliminary and final certificates-of-eligibility in Fiscal Years 2002 and 2003. For each of the 66 applications, we reviewed Department files to determine whether applicants submitted all required documentation, were eligible to participate in the program, and complied with all program requirements.

To determine whether the Department is properly administering the program to ensure that applicants remain eligible for program benefits, we reviewed a random sample of 50 cases out of a total population of 3,658 applications associated with properties that were receiving exemptions in Fiscal Year 2004. Our sample of 50 cases was selected from a mainframe computer database of all properties receiving an exemption on February 6, 2004. We reviewed documentation in Department files for the 50 cases and checked whether applicants had submitted continuing-use certificates. We also conducted visual inspections of the properties associated with the 50 cases to determine whether their use was consistent with that approved under the original applications and/or their 2003/2004 certificates-of-continuing-use. Finally, to determine whether any action was taken against property owners who had not complied with all program requirements, we obtained from the Department a list of properties whose benefits were suspended in tax years 2002/2003 and 2003/2004. The results of the above tests, while not projectable to all applicants receiving program benefits, provided a reasonable basis to assess administrative compliance with program Rules.

In order to determine whether the Department is properly calculating exemptions, we reviewed a random sample of 12 cases (each representing a different type of benefit) out of a total population of 3,658 applications associated with properties that were receiving exemptions in Fiscal Year 2004. We reviewed documentation provided by the Department for the 12 cases, and performed independent computations.

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.

Scope Limitation

As mentioned earlier, we reviewed files for 66 properties for which the Department issued both preliminary and final certificates-of-eligibility in Fiscal Years 2002 and 2003. It should be noted that the Department conducted a cursory review of at least 11 of these application files prior to our review. Although there is no indication that the Department manipulated data in these files, the integrity of the data in these cases could have been

compromised. The Department agreed to discontinue this practice after discussions with the Comptroller's Office.

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 May 20, 2005. On May 25, 2005, we submitted a draft report to Department officials with a request for comments. We received written comments from the Department on June 14, 2005.

In their response, Department officials stated, ". . . While the report presents several worthwhile findings, we strongly disagree with the majority of conclusions that your staff has drawn from its findings. . . . It should also be noted that there appears to be a fundamental difference of opinion between the audit's interpretation of the ICIP program legislation and how the program is administered through the Department of Finance. The Department of Finance believes the legislative statutes, their intent and spirit, should be paramount in guiding the administration of the program whereas the audit presents the Department's admittedly outdated published rules as controlling all in the proper administration of the program. . . . The Department intends to actively pursue the adoption of new rules that recognize the legislative statutes."

The Department agreed or partially agreed with all 20 of our recommendations. Thus, the Department's strong disagreement with the majority of our audit conclusions seems curious since our recommendations are based on those conclusions.

Our review is based on the existing Rules and legislation governing the program. Notwithstanding the Department's belief that these rules are "outdated," the Department has failed to adopt new Rules and has not developed any other written policies, procedures, or guidelines for the program. In fact, the Appellate Division for the First Department has already ruled that the Department is bound to apply its own Rules as written until and unless the Department adopts new Rules in their stead. While the Department indicates that it will "actively pursue the adoption of new rules," it has been attempting to do so without success since 1999 or earlier.

Administering a program without following established rules is unacceptable for the management of any government benefit program. It is especially intolerable when the program has provided and continues to provide millions of dollars in benefits—moneys that the City otherwise could be collecting in taxes.

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

FINDINGS AND RECOMMENDATIONS

We found that the Department properly calculates the amount of individual exemptions. However, we noted significant weaknesses in the administration of the program. Specifically, the Department does not have adequate internal controls to ensure that it properly reviews and approves applications for program exemptions and abatements and does so in a timely manner. As a result, the Department approved applications for applicants who did not adhere to the Rules governing the program. Applicants did not submit documentation when required, and Department files did not contain all necessary documentation to indicate whether applicants had fulfilled various program requirements. In addition, the Department improperly granted certificates-of-eligibility to owners of 11 of the 66 applications reviewed. Additionally, the Department does not have adequate procedures to complete inspections in a timely manner to ensure that improvement work does not start before an applicant submits a preliminary application.

Moreover, the Department does not effectively administer the program to ensure on an annual basis that applicants remain eligible for program benefits. The Department did not suspend or adjust program benefits for properties whose use changed, thereby becoming ineligible for benefits. In addition, if the Department allows these properties to remain in the program, the City will forgo taxes on these properties in future years. Finally, the Department did not suspend program benefits for properties for which required certifications of continuing use were not submitted. As a result of these weaknesses, for the properties in our sample, the City failed to collect $2,527,013, and will forgo in future years tax revenue totaling at least $1,429,998.

We also found that Department databases containing information about program applications are unreliable.

Clearly, these problems point to serious deficiencies in the Department's oversight of the program and indicate a lack of checks and balances. In addition, because the program's Rules are not consistently applied, the program is susceptible to fraud and abuse.

These matters are discussed in greater detail below.

The Department Is Not Properly Reviewing and Approving Applications for Program Benefits

The Department does not have adequate internal controls to ensure that it properly reviews and approves applications for certificates-of-eligibility and does so in a timely manner; and that applicants fulfill all program requirements before being granted certificates-of-eligibility. As a result, the Department approved applications for applicants who did not submit project documentation within the timeframes required by the Rules governing the program. In fact, the Department itself did not issue preliminary certificates-of-eligibility until an average of 663 days after their effective date.

The Rules require that applicants fulfill certain requirements in order to be granted a certificate-of-eligibility. These include: notifying the Exemptions Unit in writing at least 15 days before commencing improvement work, submitting a final application within 30 days after commencing work, notifying the Exemptions Unit in writing within 15 days of completing improvement work, and submitting a final construction report within 60 days of completing improvements. However, for the 66 cases for which the Department issued preliminary and final certificates-of-eligibility in Fiscal Years 2002 and 2003 we found:

- 14 (36%) of 39 cases for which Department files contained a written notification of construction commencement date that were not submitted by the applicants at least 15 days before construction started. In these cases, notifications were submitted between 4 and 207 days late.

- 61 (92%) of 66 cases in which applicants did not submit a final application within the required 30 days after commencing construction. In these cases, applications were submitted between 13 and 3,718 days late—more than ten years late. In one additional case, the applicant improperly submitted the final application 24 days before commencing construction.

- In 30 (55%) of 55 cases for which Department files contained a written notification of construction completion date, the notifications were not submitted by the applicants within the required 15 days. In these cases, notifications were submitted between five and 1,044 days late. In five additional cases, written notification was improperly submitted before construction was completed.

- In 46 (81%) of 57 cases for which Department files contained final construction reports, the reports were not submitted by the applicants within the required 60 days of completing construction. In these cases, reports were submitted between five and 1,227 days late. In one additional case, the final construction report was improperly submitted before construction was completed.

In the following cases, we were unable to determine whether applicants fulfilled program requirements because Department files lacked required documentation:

- 27 (41%) cases for which Department files did not contain an applicant's written notification of construction commencement date.

- 12 (80%) of the 15 cases whose construction costs exceeded $1 million lacked all required interim construction reports in Department files.[1] For the remaining three cases, at least one interim report was missing from the files.

[1]There was one additional case whose construction cost was greater than $1 million. However, the applicant was not required to submit interim construction reports because the construction was started and completed between the reporting dates of June 5 and December 5.

- 11 (17%) cases for which Department files lacked appropriate documentation to determine whether applicants had submitted written notification of the construction completion date. For an additional two cases we were unable to determine whether the notification was submitted timely.

- 9 (14%) cases for which Department files lacked final construction reports. In one further case for which the file contained a final construction report, we were unable to determine whether it was submitted on time because the file lacked information about the construction completion date.

During the course of our audit work on March 18, 2004, we provided Department officials with a tentative list of missing file documentation. We asked Department officials to provide the documentation, or explain why it was missing. However, Department officials did not respond to our request.

Department officials stated that failure to submit required items should not necessarily disqualify applicants from the program. However, the Department's refusal to consistently enforce the provisions of the program leads to an environment lacking adequate checks and balances, thereby leaving the program susceptible to fraud and abuse. (While we did not find any actual cases of fraud and abuse, such cases could easily occur.) It should be noted that a 2001 New York State audit of the program found similar problems pertaining to the Department's failure to ensure that applicants submit required documentation.[2] Although Department officials agreed with the audit's recommendations that the Department "complete efforts to streamline ICIP eligibility requirements as expeditiously as possible" and to "vigorously monitor and assess the eligibility of projects for ICIP benefits," these efforts have not taken place in the nearly four years since the State audit was issued.

Interviews with Department staff and our review of the records indicate that the Department does not have formal written policies and procedures that cover program guidelines in accordance with program Rules, and that stipulate timetables for reviewing applications. Moreover, the Department lacks a log or database that adequately highlights late or missing submissions of required documentation. Clearly, the implementation of such procedures and logs are important internal controls to ensure that the Department properly reviews and approves applications for program benefits. Given that the program's benefits amount to approximately $300 million in exemptions and abatements, it is critical that the City's interests be protected by ensuring that benefits are granted only for properties that meet all program guidelines.

Department Response: "The audit report criticizes the program for its failure to strictly enforce four filing deadlines at which time applicants are asked to provide written notices to the ICIP Unit, including: (a) 15 days prior to commencement of construction; (b) 15 days after completion of construction; (e) submission of final application 30 days after commencement; (d) submission of final construction reports within 60 days of completion. Not one of these requirements is statutory. It should be noted that these suggested filing dates are found in the Department's rules but are not incorporated in the

[2] State of New York, Office of the State Comptroller, Report 2000-N-10, issued March 21, 2001.

ICIP statute. Thus, the failure to strictly comply with such procedural matters does not result in mandatory disqualification or revocation of benefits. As an "as-of-right" program, an applicant who meets the statutory requirements for an exemption is entitled to the applicable benefits.

- "Having found that a significant number of applicants failed to adhere strictly to these suggested timetables, the report suggests that the program is susceptible to fraud and abuse. However, in fact, the report indicates the Comptroller's staff found no instances of fraud or abuse in their review. Indeed, the Department has been and remains firmly committed to properly administering the ICIP. . ."

Auditor Comment: As the Department correctly notes, the four filing deadlines are included in the Department's rules governing the program. Notwithstanding the Department's selective refusal to adhere to its own Rules, Department officials stated in a June 6, 2003 written response to an inquiry that "applications are evaluated pursuant to the laws and rules governing ICIP." Clearly, this requirement includes the Department's Rules, and contradicts the Department's contention in its response to this report that the filing dates are only "suggested."

Although the report did not cite specific instances of program fraud and abuse, the Department's discretion in following some program rules and regulations but not others leaves the program highly susceptible to mismanagement, fraud, and abuse. The Department has failed to follow the current Rules and to establish formal written guidelines that would protect the integrity of a program upon which the Department itself and the public could rely. The failure to apply standards on a consistent basis leaves program applicants with no basis on which to appeal a Department decision under the program and no way to prove that they were unfairly or improperly treated. It also leaves regulators with no basis on which to determine whether an applicant unlawfully benefited from favoritism.

Recommendations

The Department should:

1. Prepare formal written policies and procedures that comply with program Rules that cover program guidelines, that stipulate timetables for reviewing applications, and that levy penalties for failure to submit documentation. Ensure that appropriate Department staff is instructed in program policies and Rules.

Department Response: "Agree. The Department is preparing revised rules that will provide a user-friendly manual that applicants can use as a road map to navigate through the various stages of the application process. Applicants will, as always, be required to meet the legal burden of proof for exemption eligibility."

Auditor Comment: We expect that if the Department actually adopts new Rules, the Department will enforce them on a consistent basis and ensure that applicants submit all

required documentation. In the meantime, the Department must enforce the existing Rules.

2. Maintain and review a log or database that adequately highlights late or missing submissions of required documentation.

Department Response: "Agree. The Department is studying the feasibility of retaining professional consultants to upgrade the program's computerized database and to reconcile ICIP-specific data with the more detailed property-related information contained on the Department's mainframe computer. The database could be enhanced to 'flag' the statutory deadlines for transmitting essential information."

Auditor Comment: The computerized database should also "flag" deadlines and other program requirements in the Department's Rules.

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

Department Response: "Agree. The Department is committed to reducing bureaucracy and streamlining and simplifying the entire filing and application process. We have successfully de-emphasized reliance on tedious hardcopy filings in favor of faster electronic communications between applicants and the Exemption staff. We are also committed to the proper recording and maintenance of supporting documentation in files."

Auditor Comment: We support the streamlining of the filing and application process provided that the Department does not neglect its responsibilities in ensuring that applications are properly reviewed and scrutinized. The Department provided no evidence to support its claim that it has successfully de-emphasized reliance on hardcopy filings. In fact, all the applications provided to us by the Department during our audit work were in hardcopy. As our review indicated, many of these files lacked supporting documentation.

4. Enforce the provisions of the Rules governing the program on a consistent basis.

Department Response: "Agree. The Exemption staff will continue to administer all aspects of the program in a manner that is wholly consistent with the requirements of the ICIP enabling statutes and the objectives of the Legislature. As described above, our rules will be revised and the revisions promulgated."

Auditor Comment: The Department's agreement to our recommendation is incomplete. While agreeing to administer the program consistent with the requirements of the ICIP statute, the Department must also administer the program consistent with the requirements of its existing Rules. Until the Department successfully adopts new Rules, it is bound to follow the current ones. As indicated by the results of our audit, the failure to do so results in a critical lack of controls to ensure that program guidelines are applied consistently.

Improper Certificates-of-Eligibility Granted

The Department improperly granted certificates-of-eligibility to owners of 11 (17%) of the 66 sampled applications. These certificates were granted even though the work on which they were predicated was ineligible according to the Rules because it was for "ordinary repairs, replacements, or redecoration," or because it fell short of the Rules requirement of a "substantial renovation." Accordingly, owners of the 11 properties should not have received program benefits because applicants would not have met minimum required expenditures had ineligible work been excluded.[3] As a result, as discussed in our audit FR03-169A, the City did not collect tax revenue and will forgo additional tax revenue in future years for these properties.

Ten of the 11 properties were granted abatement benefits only, an issue that was discussed in greater detail in our audit FR03-169A. In the case of the property that was granted an exemption benefit (application 6811), the improvements were to repair 32 windows for $72,000, install 16 commercial ceiling fans for $4,000, and to build a refrigeration cooling room for $12,000. However, in its review of the application, the Department should have excluded the window repairs as ineligible work. The total cost of the remaining items (fans and cooling room) was only $16,000, which was insufficient to meet the project's $40,500 minimum required expenditure. The application, therefore, should have been rejected and deemed ineligible for program benefits.

These problems can be attributed to the Department's lack of qualified personnel to review and analyze work descriptions on the applications. The organization chart provided us by the Department indicates that the Exemptions Unit does not employ personnel with credentials, such as licensed professional engineers or registered architects. The lack of appropriate personnel is clearly borne out by our examination of the sampled applications, none of which contained evidence that Exemptions Unit staff had done any reviews to ascertain whether improvement work was eligible.

Department Response: ". . . This issue has been addressed at length in a separate audit report.

- "This Audit entirely ignores the legislative history of the program. The Rules, including section 14-10, were drafted in 1986 when the only tax benefit provided by the ICIP was a tax exemption for the increase in assessed value attributable to the physical construction. As the exemption base was defined in the statute, it was impossible to grant a tax exemption if the construction work did not result in an assessment increase. Nearly a decade later, the Legislature added the abatement provision for qualifying industrial properties. As provided by the statute, the abatement was designed to reduce the pre-construction taxes on the property for a period of years, with no link to post-construction assessment increases. As already acknowledged, the rules need to be updated.

[3]The Department subsequently revoked the benefits for one of the 11 properties for reasons unrelated to ineligible work or failure to adhere to minimum required expenditures.

- "The Audit does not acknowledge that government agencies generally have discretionary authority to reasonably interpret and implement legislation to effectively fulfill the objectives of a program in order to make the determinations that must be made in their day-to-day administration. In the years between enactment of the original ICIP and the amendment adding the tax abatement for qualifying industrial construction work, industrial companies wishing to remain in the City were increasingly displaced as such properties were renovated for more profitable commercial use. Additionally, the City's ICIP experience showed that many small industrial projects, while increasing the utility and life of such properties, did not generate increases in assessed value that would lead to the grant of a tax exemption. As a result, the ICIP was amended to provide a tax incentive (the abatement of pre-existing taxes) for such properties. It should be noted that the Department has, on many previous occasions, refuted the Auditor's assertion that an increase in assessed value is a pre-condition to the grant of ICIP abatements. The Department's complete response to this argument is contained in the draft response to Audit FR03-169A."

Auditor Comment: The Department refers to a separate report (Audit No. FR03-169A) that dealt with the Department's practice of providing abatement benefits to applicants even though the work on which the abatement was predicated did not result in an increase in assessed value, in violation of Rules §14-10. The Department has chosen to respond to the current audit by repeating the same line of reasoning that it previously used. However, that reasoning was flawed because reading the abatement statute and the Rules together, it is clear that to satisfy the minimum required expenditure for abatements, construction work must create or enhance the value of the property. As discussed in the prior audit, contrary to the Department's contention that we ignored the program's legislative history, not one line in the abatement program's legislative history renounces that longstanding requirement.

In any event, the 11 projects identified in this audit would not have met minimum required expenditures had the Department excluded ineligible work, which according to the Rules consisted of "ordinary repairs, replacements, or redecoration," or fell short of the Rules requirement of a "substantial renovation." Therefore, owners of the properties should not have received program benefits.

Recommendations

The Department should:

5. Ensure that only improvement work eligible under the Rules be qualified to fulfill minimum required expenditure amounts.

Department Response: "Agree. The Exemption staff will continue to work closely with the assessor to ensure that only eligible work receives benefits."

Auditor Comment: We infer from the Department's agreement to our recommendation that it will take steps to revoke the exemption benefit to the property (application no. 6811) we identified as having ineligible work. As stated above, if the ineligible work had

been excluded from that application, the applicant would not have met the minimum required expenditure for obtaining an exemption benefit.

6. Assign and instruct appropriate personnel to review and analyze work descriptions in applications to determine whether work is eligible for program benefits. Maintain written documentation of these reviews in application files.

Department Response: "Agree. We believe that the ICIP staff, acting in conjunction with the tax assessors, will continue to review applications and supporting materials."

Auditor Comment: We hope that the Department will not simply review applications, but, more important, will properly analyze work descriptions to determine whether work is eligible for program benefits. Therefore, employing staff with appropriate backgrounds is important to ensuring that consistent engineering standards are applied and that reviews are conducted in accordance with the Rules.

Problems with Property Inspections

The Department does not have adequate procedures to complete inspections in a timely manner to ensure that improvement work did not start before an applicant submits a preliminary application. As a result, inspections were either not conducted, were conducted late, or were conducted after improvement work had commenced. According to New York State Real Property Tax Law (Title 2-D) §489-dddd.3., if improvement work has started before a preliminary application is submitted, a project is not eligible for program benefits. The Rules require that applicants notify the Exemptions Unit in writing at least 15 days before beginning improvement work. Department policies also require that assessors from the Property Tax Unit conduct preliminary inspections of properties prior to the commencement of improvement work and submit the inspection results to the Exemptions Unit within two weeks. However, despite these stipulations, we found that:

- In 4 (6%) of 66 cases, inspections were apparently not conducted. Department files for three of these cases did not contain preliminary inspection reports, while one file contained a blank report, indicating that no inspection was performed.

- 7 (11%) of the 62 inspections that were conducted were conducted after improvement work started. The inspections were performed between five and 54 days after work commenced. For four of the late inspections, there was no file documentation to indicate whether or not applicants properly notified the Department 15 days before work started; in three of the late inspections, applicants notified the Department in less than the required 15 days.

- 19 (31%) of the 62 inspections that were conducted were performed beyond the required two-week period. In addition, we were unable to determine whether an additional 27 of the 62 inspections were conducted in a timely manner because Department files lacked appropriate documentation.

- 26 (42%) of 62 inspection reports were completed and submitted to the Exemptions Unit beyond the required two-week period. In one case, the report was submitted to the Exemptions Unit 123 days, or more than 17 weeks, late. We were unable to determine whether an additional 26 of the 62 inspection reports were submitted in a timely manner because the reports lacked date stamps.

As a result of untimely inspections, the Department may not be able to certify that improvement work had not started before a preliminary application was submitted, a requirement for obtaining program benefits. Some of the late inspections occurred because applicants did not notify the Department at least 15 days before their impending construction commencement date or did not notify the Department at all. As previously noted, the Department failed to enforce this requirement for 36 percent of applicants. Thus, the problem stems from the fact that the Exemptions Unit and the Property Tax Unit lack appropriate procedures governing inspections. Consequently, program guidelines are not consistently enforced, once again leaving the program open to the possibility of fraud and abuse. Accordingly, the Department must implement more effective controls to ensure that inspections are conducted in a timely manner and that applicants notify the Department prior to their construction commencement date.

Department Response: "The ICIP statute contains two important provisions regarding the filing of applications prior to construction work. First, RPTL §489-bbbb(7) limits eligibility for tax benefits to industrial, commercial or renovation construction described in approved plans. Second, RPTL §489-dddd(3)(d) restricts benefits exclusively to the assessed value of improvements made after the issuance of required building permits. As a result of these provisions, the Audit concludes that physical inspections of ICIP project sites by assessors must be subject to rigid time constraints and that any delay in such inspections automatically prevents the Department from determining whether construction has improperly commenced prior to the filing of an application, requiring a disqualification for benefits. While a timely inspection of the project site may be valuable, it is certainly not the exclusive method of determining whether construction has commenced prematurely.

- "Assessors inspect construction sites and review plans filed with the Department of Buildings in the ordinary course of business. This is not done solely to monitor ICIP projects. Additionally, Ad. Code §11-209 requires that the building value of new commercial buildings be removed from the assessment roll where the building in the course of construction is not ready for occupancy by April 15. A high percentage of ICIP projects fall within this category. As a result, these project sites are routinely reviewed for the purpose of providing the so-called "progress" assessment.

- "Finance can monitor the status of construction projects by reference to readily available materials contained on the Department of Buildings website. These files provide copies of permits issued and records of all application filed. Moreover, ICIP staff routinely monitor the DOB website for evidence of violations relating to unauthorized construction work. Whether the result of assessor inspection or review of available material on the DOB website, the Department has denied or revoked benefits in several cases where the property owner has DOB violations relating to

construction work commenced, and even completed, prior to the filing of ICIP preliminary applications.

- "When an inspection has occurred after commencement of construction, the assessor can readily ascertain whether the construction commenced prematurely by noting the degree of construction activity that has occurred since the start date set forth in the application. On several occasions, assessors have disclosed the probability that construction began prematurely based upon the stage of construction that should have reasonably existed given the stated commencement date in the application compared with the extent of actual construction. As there is a legal presumption in favor of taxation, any indication that the applicant may have started work prematurely casts the legal burden of proof on the applicant to prove by a preponderance of the evidence that the work began after the necessary approvals. Thus, the availability of abundant complementary resources available to the Department enables us to comply with the requirements of the law."

Auditor Comment: It appears that the Department has misinterpreted the audit by contending that our understanding of the requirement for timely property inspections is based on certain sections of the legislation. In fact, physical inspections of properties are required by Departmental procedures. When we questioned the Department regarding its policy in this matter, Department officials responded in writing on June 23, 2004, stating that "in order to check that no work has occurred prior to the issuance of a building permit or prior to the filing of the preliminary application, assessors are required to inspect the project site." The Department provided no evidence to show that it had in fact followed its procedures for the cases cited in the report.

Likewise, the Department provided no evidence to support its contention that it monitored the status of construction projects using the Department of Building Web site. In fact, during the audit, Department officials did not mention that they used Department of Building records to monitor construction projects. Therefore, we are unable to ascertain the effectiveness of such a method. In any case, as stated above, the Department's policy requires that assessors inspect the project site. Obviously, preliminary inspections by assessors are the most effective means of ensuring that work has not started before the construction commencement date.

Recommendations

The Department should develop written procedures and implement controls to ensure that:

7. Applicants notify the Department about the construction commencement date at least 15 days before construction begins so that inspections are conducted in a timely manner. The Department should not grant program benefits to those applicants who fail to comply.

Department Response: "Partially agree. ICIP is an 'as-of-right' program and benefits cannot be denied where the applicant has met all statutory criteria for exemption. The Exemption Unit will continue to promote and encourage applicants to satisfy the notice requirements via electronic transmissions. The use of readily available technological resources has already significantly reduced the time the staff must devote to filing hardcopy documents so that more time can be devoted to analysis of substantive criteria for eligibility. This requirement is not statutory and is not an appropriate basis for denying as of right benefits."

Auditor Comment: We disagree with the Department's position that benefits cannot be denied to applicants who meet all statutory criteria, granted that the statute itself directs the Department to promulgate Rules to implement the program. The Department has cited to us no authority to indicate that where a statute authorizes the promulgation of rules for its implementation, benefits must be awarded despite admitted non-compliance with those rules.

8. Preliminary inspections of all properties being considered for program benefits are conducted immediately following an applicant's notification of the construction commencement date.

Department Response: "Partially agree. While we will rely on the assessors for inspections when needed, we will also continue to work closely with the assessors and to take advantage of readily available materials on the Department of Buildings website to monitor the progress of ICIP construction projects."

Auditor Comment: As stated earlier, the Department provided no documentation to verify the claim that it monitors ICIP projects with materials on the Building Department website. Therefore, we maintain that preliminary inspections by assessors are the most effective means of ensuring that work has not started before the construction commencement date.

9. Inspections are conducted and reports submitted to the Exemptions Unit in a timely manner.

Department Response: "See Response to Recommendation #8."

The Department Is Not Effectively Administering the Program to Ensure Continuing Eligibility

The Department does not effectively administer the program to ensure on an annual basis that applicants are entitled to continue receiving program benefits. The Department did not suspend properties from the program or adjust their benefits when their use changed, thereby causing them to become ineligible. As a result, in tax year 2004/2005, the Department failed to collect at least $239,225 in property taxes for seven properties in our sample that are no longer eligible for benefits. (See Table I on page 18 for examples.) Moreover, since the exemptions

granted under the program will benefit these properties for up to 20 additional years, the Department will forgo approximately $1,429,998 in additional taxes in future years if these properties are allowed to remain in the program.

In addition, the Department did not suspend benefits for properties that lacked a continuing-use certificate. Consequently, $2,287,788 in tax revenue was forgone since tax year 2003/2004. Finally, the Department did not obtain documentation from applicants showing that they complied with the program Rules pertaining to correcting code violations. As a result, the Department cannot ensure that property owners corrected the violations on their properties and are still entitled to program benefits.

Failure to Suspend Benefits for Ineligible Property Use

Properties for seven (14%) of 50 sampled cases were being used entirely or partly for ineligible purposes. (See Table 1 below.) These purposes were different from those under which they were granted their original certificates-of-eligibility, but the different purposes were not reported on the 2003/2004 continuing use certificate.[4] In these cases the Department failed to revoke or adjust program benefits as required by the Rules governing the program. As a result, in tax year 2004/2005, the Department failed to collect $239,225 in property taxes due on the seven properties. Moreover, since the exemptions granted under the program benefit these seven properties for up to 20 additional years, the Department will forgo approximately $1,429,998 in additional taxes on the properties in future years.[5]

Table I
Properties with Ineligible Use

Application Number	Borough, Block, Lot	Address	Certified Use	Present Use
5207	1/93/1	81 Fulton St., a.k.a. 150 William Street	commercial	approximately 90% government offices
4537	3/6343/17	8510 Bay 16th Street	commercial	approximately 30% occupied by union local
4213	2/5331/13	3225 East Tremont Ave.	commercial	100% occupied by union local
3853	4/4076/19	15-16 122nd St., a.k.a. 15-16 College Point Blvd.	commercial	approximately 50% not-for-profit use
5741	5/16/54	350 St. Mark's Pl.	commercial	approximately 60% government offices, and 20% not-for-profit use
6922	3/2479/23	59-77 Box St.	industrial	approximately 40% commercial use (construction pre-fab, parts distribution, sound studio)
7581	4/745/136	25-25 49th St.	industrial	100% commercial use by electrical contractors

[4]Department files did not contain 2003-2004 certificates for two projects.

[5]Our projection of future forgone revenue assumes that there are no changes in the tax rate or in the physical assessed value of the properties.

Certain properties that were granted industrial exemptions were being used for non-industrial purposes such as a contracting business and a sound studio. In other cases, properties that were granted commercial exemptions were being used for non-eligible purposes (i.e., government offices, trade union offices, and not-for-profit organizations). Rules §14-16 states that program eligibility requires the continued use of buildings and property for the purpose specified in the application as last amended or in the certificate-of-continuing-use. Furthermore, Rules §14-15(a) state, "The receipt of benefits for a tax year or part thereof, shall be contingent upon continued eligibility."

Department policy required assessors of the Property Tax Division to inspect properties participating in the program to ensure that they were being used for their stated purpose. However, Department officials informed us that they discontinued this practice in tax year 2002/2003 because they believed that properties were generally conforming to their stated use. But even when inspections were conducted in previous years, Department files indicate that inspection forms were frequently incomplete and/or incorrectly filled out, indicating that inspections were not thorough and that controls were inadequate. Therefore, the Department's decision to discontinue inspections may have been based on faulty or incomplete information. Based on our observations of the 50 sampled properties, it is apparent that many properties are being converted to non-conforming uses. Therefore, inspection of properties that receive ongoing program benefits is a critical control to ensure continued compliance with program guidelines and that exemptions and abatements are given only to properties that are eligible for such benefits.

Department Response: "The Audit also provided a table of seven applications labeled as 'properties with ineligible use,' concluding that the properties improperly received an estimated $239,225 in property tax exemption benefits in tax year 2004/05. In the view of the Audit, the revenue loss will be further exacerbated because it is assumed these properties will receive future tax benefits of approximately $1,429,998.

- "The Department has reviewed the seven applications noted by the Audit. The Audit staff inspected two buildings that received certificates of eligibility for industrial construction and discovered that the owner had converted a portion of the manufacturing space to commercial use. Adjustments are being made in these two cases which are discussed separately in the Appendix to this report."

Referring to Application no. 6922, the Department stated in the appendix to its response, "Although the property's industrial use has fallen below the 75 percent statutory threshold, the exemption will not change due to the property's location in a special commercial exemption area. The property did, however, receive inappropriate abatement benefits for fiscal years 2003/04 and 2004/05 as a result of the applicant's false representations. The Department will now impose these taxes and the interest accrued based upon the statutory provision described above."

Referring to Application no. 7581, the Department stated in the appendix to its response, "A tax assessor inspected the site on May 20, 2005 and, despite the lack of cooperation by the owner of the property, the assessor was able to confirm that less than 75 percent of

the building is now used for industrial purposes. Because there were no positive equalization assessment increases imposed on this property since its initial exemption year, no excessive exemption benefits have been granted. However, the Department will revise the database to reflect the property's more limited tax exemption benefit due to its conversion—it will have a fixed exemption base of $11,440. As the property did not qualify for a tax abatement, no adjustment in tax liability for prior years will be necessary."

In the appendix to its response, the Department also responded, "Given the substantial remedial authority granted to the Department by the statutes, we appreciate the additional information uncovered by the Audit. However, it should be noted that the Audit's projected revenue losses as a result of changes in use have been greatly exaggerated. The one actual instance of a property wrongly receiving tax abatement benefits, in the amount of $34,660.26, will be collected with interest plus the statutory three percent penalty.

- "The Audit claims that five projects should have had their ICIP benefits for commercial construction work revoked because government agencies, union locals or not-for-profit organizations are occupying portions of the buildings in question. This claim is based on the originally drafted ICIP rules (1984) that disallowed benefits for buildings in which office space was leased to government agencies or not-for-profit organizations. The policy at that time deemed space leased to such entities as ineligible for benefits because they were not considered commercial or for-profit tenants whose activities would further the economic development objectives of the program. In 1993, the Commissioner of Finance approved a policy to reflect the realities of the City's economy and commercial real estate marketplace. Both government agencies and not-for-profits constitute a significant and much-valued sector of the City's economy. It has become quite common for government agencies to lease significant space in major commercial developments such as Metro Tech in downtown Brooklyn. Draft rules amending this provision were circulated but were never formally promulgated by the Law Department. Nevertheless, the change in policy was widely disseminated throughout the real estate community through such organizations as the Real Estate Board of New York. Applicants inquiring about the eligibility of space leased by government agencies, not-for-profits and union locals are immediately assured by the staff that such uses are clearly eligible for ICIP benefits. Thus, the putative "illegal conversions" to government or not-for-profit use that the Audit seeks to highlight have, in fact, been perfectly legitimate and eligible commercial uses for well over a decade. Therefore, any revenue loss that the Audit attributed to these properties is unfounded."

Auditor Comment: We disagree with the adjustments that the Department has agreed to make for two of the seven properties that were used partly or entirely for commercial rather than industrial purposes and for which certificates-of-eligibility were granted. Rules §14-09(c)(1) states that a commercial property is eligible for benefits only if it is on a non-industrial building site, regardless of the area's overall designation. In both cases, the properties are ineligible for benefits because they are located on industrial

building sites. Therefore, the Department should revoke these properties' benefits entirely, not simply adjust them.

Regarding the five properties that were being used for government, trade union, or not-for-profit purposes, the Department acknowledges that the ICIP Rules do not allow benefits for properties used for these purposes. However, the Department has apparently chosen to disregard the Rules and purports to have approved a 1993 "policy" permitting these ineligible uses. The Department made no mention of such a policy at any time during our audit work and provided no documentation to substantiate its existence or content. The Department admits that its attempt to incorporate this policy into new Rules did not result in promulgation. Thus, the Department must adhere to its existing Rules until such time as new Rules are promulgated and adopted. By not consistently enforcing the Rules, the Department is leaving the program open to fraud and abuse.

Recommendations

The Department should:

10. Ensure that certificates are submitted for all properties. In the event that certificates are not submitted, the Department should suspend program benefits for those properties.

Department Response: **"**Partially agree. The Department has introduced State legislation that would make filing of certificates of continuing use a biennial, rather than an annual event. This change will enhance the ability of the ICIP staff and the assessors to monitor applicant's compliance with industrial and commercial use requirements. While the Department is legally authorized to suspend benefits in such cases, the law does not mandate suspensions. The Department prefers to avoid such drastic remedies in an 'as-of-right' program."

Auditor Comment: Until such time as new legislation is adopted, the Department must continue to adhere to the existing law.

11. Conduct a thorough review of an applicant's certificate-of-continuing-use, the inspection report, and other supporting documentation to determine whether a property remains eligible for program benefits.

Department Response: **"**See Response to Recommendation #10."

Auditor Comment: The Department's reference to its response to recommendation no. 10 does not directly address our recommendation for conducting thorough reviews. Therefore, we do not know whether the Department plans to implement this recommendation or whether it will be taking other steps to identify properties that are no longer eligible for program benefits.

12. Conduct inspections of properties receiving ongoing benefits to verify that the property's use has not been converted to an ineligible use.

Department Response: **"**Agree. We will continue to work with the assessors to insure that the applicants continue to use the benefited parcels for the exempt purpose that initially gave rise to the exemption and/or abatement benefits."

Auditor Comment: It is unclear from the information provided by the Department how it intends to "work with the assessors" to ensure compliance. Obviously, the Department's procedure, if followed, of inspecting properties to ensure that they conform to their stated use would be the most effective method for ensuring that a property's use has not been converted.

13. Suspend or revoke benefits to properties that do not comply with program requirements regarding continuing use. In particular, the Department should suspend or revoke the incorrectly granted benefits for those properties identified in this report and recoup those benefits.

Department Response: **"**Agree. We will continue to revoke or reduce benefits, as required by law, upon discovery of changes to ineligible uses. We will also continue to revoke exemptions from the date of the prohibited use, with interest and penalty, as specifically mandated by the ICIP enabling laws."

Failure to Suspend Benefits for Missing Certificates

The Department did not suspend benefits for all properties that lacked a continuing-use certificate. (See Appendix.) In order to receive benefits, Rules §14-36 require applicants to submit annually a certificate-of-continuing-use to the Department. Of 50 sampled cases, 47 were required to submit continuing use certificates in tax year 2002/2003. We found that continuing use certificates were not submitted for 29 of the 47 cases. However, the Department did not suspend benefits in any of these cases. For tax year 2003/2004, certificates of continuing use were required for all 50 sampled cases. While applicants for 17 of these cases did not submit the certificates, the Department only suspended benefits for three of them. (It should be noted that in 11 cases, although applicants failed to submit required certificates-of-continuing-use for both tax years 2002/2003 and 2003/2004, the Department did not suspend benefits.) As a result, in total, $2,287,788 in tax revenue has been forgone since tax year 2003/2004 for properties for which certificates were not submitted.[6]

Department Response: "The report criticizes the Department for failing to suspend benefits for those projects where Certificates of Continuing Use (CCUs) were not filed timely. Based on a sample of 50 cases, the Audit noted that only 18 of the 47 projects which were required to file CCUs in tax year 2003/04 actually filed these documents

[6]The estimate of forgone revenue is for 12 of the 14 properties. We included the amount of forgone revenue for the remaining two properties in the section of the report concerning ineligible property use.

timely. As a result of this finding, the Audit estimated the City lost tax revenue amounting to nearly $2.3 million from ICIP projects that failed to file CCUs in tax year 2003/04.

- "RPTL §489-ffff(2) authorizes the Department to terminate benefits where the applicant fails to file the CCU by January 5th of each year. The authority to terminate benefits is discretionary and is not required by the law. Given that the benefits are as of right, the Department has cautiously exercised this authority, restricting its use to situations where we have unequivocally determined that the benefited property has been fully or partially converted to ineligible use.

- "It appears that in estimating revenue loss, the Audit staff must have assumed that the failure to file a CCU is tantamount to having converted these properties from an eligible industrial or commercial use to an ineligible or residential use. The Audit provides no basis for their assumption. Thus, the claim that some $2.2 million of revenue was due the City in these cases has no factual basis."

Auditor Comment: The audit stated that the Department should have suspended benefits for properties that lacked a certificate-of-continuing use. The Department apparently confuses the failure to submit certificates—the concern stated in the audit—with not filing certificates timely. The Department's confusing these two issues leads us to conclude that Department officials have not carefully studied our audit results. Likewise, the Department's belief that our audit assumes that failure to file certificates is "tantamount to having converted these properties. . ." is incorrect. We make no such assumption. The estimate of a $2.2 million revenue loss is based only on benefits for the particular year(s) that certificates were not filed for their associated properties. In addition, the Department provided no evidence during the audit or in its response that for the cases cited in the audit, certificates were filed in a timely fashion.

Recommendations

The Department should:

14. Establish procedures to effectively administer the program and ensure that applicants are entitled to continue receiving program benefits. In that regard, the Department should ensure that applicants submit continuing-use certificates annually, and establish a tracking system to ensure that all applicants required to submit a certificate-of-continuing-use are sent a form.

Department Response: **"**See Responses to Recommendations # 10, 11, 12, 13."

15. Suspend or revoke benefits when property owners do not comply with continuing-use requirements. In particular, the Department should suspend or revoke the incorrectly granted benefits for those properties identified in this report. The Department should also recoup improperly granted benefits to all properties that have not complied with continuing-use requirements.

Department Response: "Agree: The Department will revoke benefits for changes in property use, where required by law. We will revoke benefits for application #6922, the only application that experienced a change in use that affected benefits granted."

Auditor Comment: The Department has misinterpreted our recommendation, which refers to suspending or revoking benefits for properties that do not comply with continuing-use requirements. As stated in the report, applicants are required to submit annually a certificate-of-continuing-use to the Department. The Department's response actually refers to the previous section of the audit dealing with suspending or revoking benefits for properties with ineligible uses. In addition, the Department should review all properties receiving benefits—not just those cited in the audit—to ensure that certificates have been submitted and the uses of the properties are still in compliance with the Rules.

16. Maintain appropriate documentation and certificates-of-continuing-use in Department files.

Department Response: "Agree. The Department appreciates this recommendation and will make every effort to improve the maintenance of files."

Missing Violation Documentation

None of the 50 sampled certificates-of-continuing-use contained supporting documentation indicating that applicants had periodically conducted a search for code violations imposed on the properties, as required by Rules §14-36(c)(2)(i). The Department did not suspend program benefits when applicants failed to provide the required documentation and as a result, certain properties may be receiving benefits to which they are not entitled. Rules §14-17(b)(1) states, "Eligibility shall be suspended upon a determination of noncompliance because of . . . entry of an adjudicated code violation against any building within the parcel."[7]

In addition, Rules §14-36(c)(1)(iv) requires that the certificate-of-continuing-use include a statement of all outstanding violations of any law or regulation governing the construction, maintenance, or operation of buildings, whether each violation is of record, and the steps being taken to cure them. Despite this stipulation, the Department eliminated an important internal control to ensure compliance with this requirement. Beginning with the certificate-of-continuing-use form for 2003/2004, the Department deleted a section of the form entitled "Statement on Arrears and Violations," which required an applicant to certify whether the property had any adjudicated and uncured code violations by responding "yes" or "no" on a check-off list.[8]

[7]An adjudicated code violation must meet the requirements of Rules §14-17(d)

[8]Moreover, the check-off list was itself deficient because it failed to encompass all outstanding violations, as required by §14-36(c)(1)(iv). Rather, it only covered adjudicated violations. In addition, it did not include the steps taken to cure violations, as required.

We conducted a search of Building Department records to ascertain whether any of the 50 sampled properties had outstanding violations. Our search indicated that none of the properties had adjudicated code violations that would result in suspension of benefits. However, 14 of the 50 properties had other outstanding violations. While these violations would not result in suspension, the elimination of the "Statement on Arrears and Violations" further weakens the Department's ability to properly administer the program and monitor compliance with the Rules.

Department Response: "The Audit also criticized the Department for not requiring applicants to provide statements and documentation with the Certificates of Continuing Use evidencing searches for adjudicated code violations. However, a simpler, more effective approach would involve self-certification by informed licensed professionals and/or owner representatives who would be held legally accountable for the representations they make."

Auditor Comment: If the Department believes it has identified an effective approach to providing evidence of searches for adjudicated code violations, then it should implement this method immediately. However, we note that the Department has agreed with our recommendations (nos. 17 and 18) to remedy this problem.

Recommendations

The Department should:

17. Restore the adjudicated code violation check-off list to the certificate-of-continuing-use form.

Department Response: "Agree. The CCU will be amended to require the applicant to certify under penalties of perjury that there are no adjudicated code violations on the subject property."

18. Ensure that applicants provide documentation to verify that a search for code violations has been conducted. Benefits should be suspended for properties that lack the required documentation.

Department Response: " See Response #17."

Auditor Comment: The Department did not respond to the portion of our recommendation about suspending benefits for properties lacking required documentation. Therefore, we do not know whether the Department plans to implement this part of the recommendation to ensure that benefits are suspended for properties that lack documentation of code compliance.

Unreliable Program Databases

The Department's mainframe computer system and the Exemptions Unit's PC databases are unreliable. Comptroller's Directive 18, §8.2, requires that agencies ensure that adequate controls be implemented to eliminate computer input, processing, and output problems. However, the Department does not have an adequate controls system to ensure that information in the program's databases is recorded and processed completely and accurately.

The Department has two databases for the program. The mainframe database is a Department-wide system that contains information pertaining to applicants who have been certified as eligible. The PC database is used exclusively by the Exemptions Unit for tracking the eligibility process. We found that 739 applications listed in the mainframe database were not contained in the PC database. We were informed by Department officials that the PC database contained all applications that received exemptions since the beginning of the program and that the mainframe database contained only applications for all properties receiving exemptions as of February 2004. Thus, the PC database should have contained all the application listings contained in the mainframe database.

Insofar as the PC database is concerned, we found numerous discrepancies between it and the source documents, as well as typographical errors and missing information. In addition, there were data entry errors in the mainframe computer. Specifically, we found the same application number listed for two distinct properties in a number of cases. For example, the exemptions database listed application number 281 for properties in both Brooklyn (BBL 3/2334/3) and Staten Island (BBL 5/3666/29).

Department officials informed us that it has not recently reconciled the PC and mainframe systems, thereby neglecting to use another important internal control for ensuring that information in the databases is accurate. Information common to both systems is manually entered into each—not uploaded directly from the PC into the mainframe.

Overall, these problems highlight another aspect of the Department's lack of adequate internal controls that hinder the Department's ability to track applications and ensure adherence to the Rules of the program.

Department Response: **"**When the current ICIP database was created approximately 20 years ago, we never anticipated the volume of data the Exemption Unit would need to maintain. The extraordinary success and continued growth of ICIP had made it difficult for the capacity of the database to effectively keep pace with the complex demands of the program. We are, therefore, seriously studying the feasibility of retaining professional consultants to upgrade the program's computer database, as suggested in the Audit. Already in progress, we are upgrading our website to provide the public with the ability to track their application's progress from start to finish; compute the actual tax savings throughout the benefit period; and determine the geographical boundary areas and benefits available to projects based on the block and lot of the subject property."

Recommendations

The Department should:

19. Implement adequate controls, as required by Comptroller's Directive 18, to ensure that program databases are complete and accurate.

Department Response: **"**Agree: We agree that the accuracy and integrity of the program's database is of paramount importance. We are therefore taking action to enhance the database, as described more fully in Response #2."

Auditor Comment: Our recommendation applies to two Department databases: the mainframe database and the exemption unit's PC database. Therefore, we expect the Department to take action to ensure consistency and reliability of information on both databases.

20. Periodically reconcile the personal computer database and the mainframe database.

Department Response: **"**See Response #2."

Appendix

Properties Lacking Continuing Use Certificate But Not Suspended from Receiving Program Benefits

Application No.	First Benefit Year	Boro	Block	Lot	02/03 CCU not in file - Benefit not suspended	03/04 CCU not in file - Benefit not suspended
719	1990	3	2517	12	X	
859	1989	3	2512	68	X	X
927	1989	2	3038	1		
1020	1992	2	3276	1	X	X
1252	1990	4	9338	69	X	
1801	1990	3	4636	6	X	X
1807	1992	3	5531	56	X	X
1950	1991	4	4095	42	X	X
2592	1994	3	1858	47	X	
2780	1993	5	724	6	X	
2873	1993	5	486	1	X	X
3246	1996	4	15537	153	X	
3428	1995	3	3348	10	X	
3853	1995	4	4076	19	X	X
4537	1997	3	6343	17	X	
5092	2003	3	6904	9		X
5118	1999	3	149	26	X	
5175	1997	4	8304	73	X	
5207	1999	1	93	1	X	
5485	1998	3	5091	61	X	X
5507	1998	4	9536	3	X	
5736	2001	3	250	1	X	
5741	1998	5	16	54	X	
5777	1998	3	5622	43	X	X
5911	1998	2	3805	11	X	X
6028	1998	3	1336	49	X	X
6040	1998	4	13094	63	X	
6524	2000	1	530	1101	X	
6922	2000	3	2479	23	X	
7404	2000	1	998	47	X	
7572	2000	4	230	25	X	
7581	2000	4	745	136		X
8370	2001	2	3027	39		X
			Total =		**29**	**14**

FINANCE
NEW › YORK
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

BY FAX AND HAND-DELIVERY

June 14, 2005

Mr. Greg Brooks
Deputy Comptroller
Office of the Comptroller
1 Centre Street
New York, NY 10007-2341

Re: Audit Report on the Department of Finance
Oversight of the Industrial and Commercial Incentive Program
FR03-181A

Dear Mr. Brooks:

Thank you for the opportunity to respond to the City of New York Office of the Comptroller (Comptroller) Draft Audit Report on the Department of Finance Oversight of the Industrial and Commercial Incentive Program (ICIP).

Before addressing the findings and recommendations, we want to briefly outline the program's nature and purpose as context for our response. The Industrial and Commercial Incentive Program is a dynamic, as-of-right, economic development program that seeks to encourage commercial and industrial expansion to targeted areas of the City. The Department of Finance (Finance) receives an average of 50 to 75 new applications each month; monitors the progress and continuing use of approximately 5,000 projects; and maintains a growing database of over 12,500 applications. Since its inception in 1984, the ICIP has resulted in thousands of jobs created and/or retained in the City, in both the construction and non-construction industries.

Designated by the State Legislature as the steward of this vital economic development incentive, the Department is well aware of the mandates it must serve. On the one hand, the Department is the program's facilitator, guiding applicants through a process that can sometimes appear complex and difficult. On the other hand, the Department must be a guardian of the public treasury, ensuring that only eligible applicants who have met and continue to meet all the requirements of the program will be granted the statutorily defined tax benefits.

During the past two years, the Comptroller has been reviewing the administration of this program, resulting in Audit Report FR03-181A, submitted for Finance's comments prior

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to release of a final report. The stated objective of the audit report was "to determine whether the Department properly reviews and approves applications for program exemptions and abatements; whether the program is administered to ensure that applicants remain eligible for program benefits; and whether exemptions are properly calculated." We firmly believe that the Department has consistently discharged these administrative tasks in a manner wholly consistent with the program's stated economic development objectives, as set forth in the enabling laws. While the report presents several worthwhile findings, we strongly disagree with the majority of conclusions that your staff has drawn from its findings.

It should also be noted that there appears to be a fundamental difference of opinion between the audit's interpretation of the ICIP program legislation and how the program is administered through the Department of Finance. The Department of Finance believes the legislative statutes, their intent and spirit, should be paramount in guiding the administration of the program whereas the audit presents the Department's admittedly outdated published rules as controlling all in the proper administration of the program. Indeed, these outdated rules do not conform to the intent of the legislation. Strict enforcement of these rules would in effect seriously damage if not destroy the program by denying the as of right benefits for small bureaucratic infractions. The Department intends to actively pursue the adoption of new rules that recognize the legislative statutes.

FINDING #1: The Department is Not Properly Reviewing and Approving Applications for Program Benefits

The audit report criticizes the program for its failure to strictly enforce four filing deadlines at which time applicants are asked to provide written notice to the ICIP Unit, including: (a) 15 days prior to commencement of construction; (b) 15 days after completion of construction; (c) submission of final applications 30 days after commencement; (d) submission of final construction reports within 60 days of completion. Not one of these requirements is statutory. It should be noted that these suggested filing dates are found in the Department's rules but are not incorporated in the ICIP statute. Thus, the failure to strictly comply with such procedural matters does not result in mandatory disqualification or revocation of benefits. As an "as-of-right" program, an applicant who meets the statutory requirements for an exemption is entitled to the applicable benefits.

- Having found that a significant number of applicants failed to adhere strictly to these suggested timetables, the report suggests that the program is susceptible to fraud and abuse. However, in fact, the report indicates the Comptroller's staff found no instances of fraud or abuse in their review. Indeed, the Department has been and remains firmly committed to properly administering the ICIP.

Over the past few years, the combined effect of greater reliance on technology, especially the Internet, and the reduction of bureaucracy to achieve greater efficiency has resulted in the streamlining and simplification of filing and application processes. This is particularly important in the administration of tax incentive programs such as the ICIP. Finance has

actively sought to simplify and de-mystify the application processes for the various exemption programs we administer.

- While the ICIP Unit still requests that applicants notify it of various milestones during the application and eligibility periods, the Department has departed from mandating adherence to discretionary filing deadlines that are not statutorily required and which risk denial or suspension of benefits that are "as of right".

- Finance can now quickly apprise applicants of filing deadlines, exemption status and other information via the Department's website. Applicants can readily avail themselves of the required forms that, in turn, can be completed and directly e-mailed to the appropriate Exemption staff. The modernization of the communications infratsructure has greatly enhanced the Departments' administration of the ICIP, most notably in response time, while significantly reducing the expenses of maintaining office space for storage of reams of hardcopy filings.

If the goal is to create or renovate industrial and commercial space at competitive prices to attract new job opportunities for New Yorkers and expand the City's tax base over the long term, then a tax incentive program must be administered to encourage such activities by removing unnecessary non-statutory obstacles. At the same time, the Department recognizes the need to establish adequate and effective procedures that serve to make the process transparent and logical and also to discourage fraud and abuse.

FINDING #2: Improper Certificates-of-Eligibility Granted (The Department improperly granted certificates of eligibility to owners who did not perform eligible construction work.)

Based on the assumption that exemptions and abatements (the latter available for only qualifying industrial projects) are subject to the same construction criteria, the Audit Report concludes that the Department has improperly granted certificates of eligibility for projects that have not completed "substantial renovation work." The Report cites section 14-10 of the ICIP Rules to support its interpretation of the law – namely, that an assessment increase resulting from physical alterations is a condition precedent to the availability of both tax exemption and abatement benefits. Specifically, the Report cites section 14-10 to "expressly provide" that "construction work shall be eligible construction work" for the purposes of granting abatements and exemptions only if it "creates or enhances the value of eligible industrial or commercial property," i.e., it increases the property's assessed value. This issue has been addressed at length in a separate audit report.

- This Audit entirely ignores the legislative history of the program. The Rules, including section 14-10, were drafted in 1986 when the only tax benefit provided by the ICIP was a tax exemption for the increase in assessed value attributable to the physical construction. As the exemption base was defined in the statute, it was impossible to grant a tax exemption if the construction work did not result in

an assessment increase. Nearly a decade later, the Legislature added the abatement provision for qualifying industrial properties. As provided by the statute, the abatement was designed to reduce the pre-construction taxes on the property for a period of years, with no link to post-construction assessment increases. As already ackowledged, the rules need to be upodated.

- The Audit does not acknowledge that government agencies generally have discretionary authority to reasonably interpret and implement legislation to effectively fulfill the objectives of a program in order to make the determinations that must be made in their day-to-day administration. In the years between enactment of the original ICIP and the amendment adding the tax abatement for qualifying industrial construction work, industrial companies wishing to remain in the City were increasingly displaced as such properties were renovated for more profitable commercial use. Additionally, the City's ICIP experience showed that many small industrial projects, while increasing the utility and life of such properties, did not generate increases in assessed value that would lead to the grant of a tax exemption. As a result, the ICIP was amended to provide a tax incentive (the abatement of pre-existing taxes) for such properties. It should be noted that the Department has, on many previous occasions, refuted the Auditor's assertion that an increase in assessed value is a pre-condition to the grant of ICIP abatements. The Department's complete response to this argument is contained in the draft response to Audit FR03-169A.

FINDING #3: Problems with Property Inspections (The Department did not complete property inspections in a timely fashion.)

The ICIP statute contains two important provisions regarding the filing of applications prior to construction work. First, RPTL §489-bbbb(7) limits eligibility for tax benefits to industrial, commercial or renovation construction described in approved plans. Second, RPTL §489-dddd(3)(d) restricts benefits exclusively to the assessed value of improvements made after the issuance of required building permits. As a result of these provisions, the Audit concludes that physical inspections of ICIP project sites by assessors must be subject to rigid time constraints and that any delay in such inspections automatically prevents the Department from determining whether construction has improperly commenced prior to the filing of an application, requiring a disqualification for benefits. While a timely inspection of the project site may be valuable, it is certainly not the exclusive method of determining whether construction has commenced prematurely.

- Assessors inspect construction sites and review plans filed with the Department of Buildings in the ordinary course of business. This is not done solely to monitor ICIP projects. Additionally, Ad. Code §11-209 requires that the building value of new commercial buildings be removed from the assessment roll where the building in the course of construction is not ready for occupancy by April 15. A high percentage of ICIP projects fall within this category. As a result, these project

sites are routinely reviewed for the purpose of providing the so-called "progress" assessment.

- Finance can monitor the status of construction projects by reference to readily available materials contained on the Department of Buildings website. These files provide copies of permits issued and records of all applications filed. Moreover, ICIP staff routinely monitor the DOB website for evidence of violations relating to unauthorized construction work. Whether the result of assessor inspections or review of available material on the DOB website, the Department has denied or revoked benefits in several cases where the property owner has DOB violations relating to construction work commenced, and even completed, prior to the filing of ICIP preliminary applications.

- When an inspection has occurred after commencement of construction, the assessor can readily ascertain whether the construction commenced prematurely by noting the degree of construction activity that has occurred since the start date set forth in the application. On several occasions, assessors have disclosed the probability that construction began prematurely based upon the stage of construction that should have reasonably existed given the stated commencement date in the application compared with the extent of actual construction. As there is a legal presumption in favor of taxation, any indication that the applicant may have started work prematurely casts the legal burden of proof on the applicant to prove by a preponderance of the evidence that the work began after the necessary approvals. Thus, the availability of abundant complementary resources available to the Department enables us to comply with the requirements of the law.

FINDING #4: The Department Is Not Effectively Administering the Program to Ensure Continuing Eligibility

The report criticizes the Department for failing to suspend benefits for those projects where Certificates of Continuing Use (CCUs) were not filed timely. Based on a sample of 50 cases, the Audit noted that only 18 of the 47 projects which were required to file CCUs in tax year 2003/04 actually filed these documents timely. As a result of this finding, the Audit estimated the City lost tax revenue amounting to nearly $2.3 million from ICIP projects that failed to file CCUs in tax year 2003/04.

- RPTL §489-ffff(2) authorizes the Department to terminate benefits where the applicant fails to file the CCU by January 5th of each year. The authority to terminate benefits is discretionary and is not required by the law. Given that the benefits are as of right, the Department has cautiously exercised this authority, restricting its use to situations where we have unequivocally determined that the benefited property has been fully or partially converted to ineligible use.

- It appears that in estimating revenue loss, the Audit staff must have assumed that the failure to file a CCU is tantamount to having converted these properties from

an eligible industrial or commercial use to an ineligible or residential use. The Audit provides no basis for their assumption. Thus, the claim that some $2.2 million of revenue was due the City in these cases has no factual basis.

The Audit also provided a table of seven applications labeled as "properties with ineligible use," concluding that the properties improperly received an estimated $239,225 in property tax exemption benefits in tax year 2004/05. In the view of the Audit, the revenue loss will be further exacerbated because it is assumed these properties will receive future tax benefits of approximately $1,429,998.

- The Department has reviewed the seven applications noted by the Audit. The Audit staff inspected two buildings that received certificates of eligibility for industrial construction and discovered that the owner had converted a portion of the manufacturing space to commercial use. Adjustments are being made in these two cases which are discussed separately in the Appendix to this report.

- The Audit claims that five projects should have had their ICIP benefits for commercial construction work revoked because government agencies, union locals or not-for-profit organizations are occupying portions of the buildings in question. This claim is based on the originally drafted ICIP rules (1984) that disallowed benefits for buildings in which office space was leased to government agencies or not-for-profit organizations. The policy at that time deemed space leased to such entities as ineligible for benefits because they were not considered commercial or for-profit tenants whose activities would further the economic development objectives of the program. In 1993, the Commissioner of Finance approved a policy to reflect the realities of the City's economy and commercial real estate marketplace. Both government agencies and not-for-profits constitute a significant and much-valued sector of the City's economy. It has become quite common for government agencies to lease significant space in major commercial developments such as Metro Tech in downtown Brooklyn. Draft rules amending this provision were circulated but were never formally promulgated by the Law Department. Nevertheless, the change in policy was widely disseminated throughout the real estate community through such organizations as the Real Estate Board of New York. Applicants inquiring about the eligibility of space leased by government agencies, not-for-profits and union locals are immediately assured by the staff that such uses are clearly eligible for ICIP benefits. Thus, the putative "illegal conversions" to government or not-for-profit use that the Audit seeks to highlight have, in fact, been perfectly legitimate and eligible commercial uses for well over a decade. Therefore, any revenue loss that the Audit attributed to these properties is unfounded.

- The Audit also criticized the Department for not requiring applicants to provide statements and documentation with the Certificates of Continuing Use evidencing searches for adjudicated code violations. However, a simpler, more effective approach would involve self-certification by informed licensed professionals

and/or owner representatives who would be held legally accountable for the representations they make.

RECOMMENDATIONS

The Department of Finance constantly strives to improve its administration of the program and, upon review of the findings and recommendations found in the Audit, we believe that several recommendations are sound and the Department will seek to implement them as quickly as possible. Although the audit report makes a total of 20 recommendations, these can be grouped into three main categories which are adressed below:

Rules

- We are committed to finalizing a concise, user-friendly version of the ICIP rules that clearly articulate the Department's current position on all aspects of the program. The document will be published on the Department of Finance website, provide a readily available guide to the ICIP for applicants and reduce the need to retain professional real estate tax consultants to navigate the application process. The rules will then serve as a transparent manual for the public and the exemption staff.

Database

- When the current ICIP database was created approximately 20 years ago, we never anticipated the volume of data the Exemption Unit would need to maintain. The extraordinary success and continued growth of ICIP has made it difficult for the capacity of the database to effectively keep pace with the complex demands of the program. We are, therefore, seriously studying the feasibility of retaining professional consultants to upgrade the program's computer database, as suggested in the Audit. Already in progress, we are upgrading our website to provide the public with the ability to track their application's progress from start to finish; compute the actual tax savings throughout the benefit period; and determine the geographical boundary areas and benefits available to projects based on the block and lot of the subject property.

Denial or Revocation of Benefits

- At numerous intervals, the report requests that benefits be denied or suspended and that penalties be imposed for every late filing or failure to provide the correct paperwork. The Department of Finance is committed to administering the program in strict conformance with the statutory requirements for benefits but will not create or enforce administrative regulations that serve as obstacles to meeting the program's objectives. Rather, the Department seeks the flexibility to adapt administrative rules when and if the circumstances allow. The program is an economic development vehicle created to spur construction and create jobs. To

accomplish this, we must reduce the bureaucracy, not add to it, as many of the recommendations would require us to do.

Below are the agency's specific responses to each of the 20 audit recommendations:

Recommendation 1: Prepare formal written policies and procedures that comply with Program Rules that cover program guideline, that stipulate timetables for reviewing applications, and that levy penalties for failure to submit documentation.

Response: Agree. The Department is preparing revised rules that will provide a user-friendly manual that applicants can use as a road map to navigate through the various stages of the application process. Applicants will, as always, be required to meet the legal burden of proof for exemption eligibility.

Recommendation 2: Maintain and review a log or database that adequately highlights late or missing submissions of required documentation.

Response: Agree. The Department is studying the feasibility of retaining professional consultants to upgrade the program's computerized database and to reconcile ICIP-specific data with the more detailed property-related information contained on the Department's mainframe computer. The database could be enhanced to "flag" the statutory deadlines for transmitting essential information.

Recommendation 3: Record and maintain all supporting documentation in department Files.

Response: Agree. The Department is committed to reducing bureaucracy and streamlining and simplifying the entire filing and application process. We have successfully de-emphasized reliance on tedious hardcopy filings in favor of faster electronic communications between applicants and the Exemption staff. We are also committed to the proper recording and maintenance of supporting documentation in files.

Recommendation 4: Enforce the provisions of the Rules governing the program on a consistent basis.

Response: Agree. The Exemption staff will continue to administer all aspects of the program in a manner that is wholly consistent with the requirements of the ICIP enabling statutes and the objectives of the Legislature. As described above, our rules will be revised and the revisions promulgated.

Recommendation 5: Ensure that only improvement work eligible under the Rules be qualified to fulfill minimum required expenditures.

Response: Agree. The Exemption staff will continue to work closely with the assessors to ensure that only eligible work receives benefits.

Recommendation 6: Assign and instruct appropriate personnel to review and analyze work descriptions in applications to determine whether work is eligible for program benefits. Maintain written documentation of these reviews in application files.

Response: Agree. We believe that the ICIP staff, acting in conjunction with the tax assessors, will continue to review applications and supporting materials.

Recommendation 7: Applicants notify the Department about the construction commencement date at least 15 days before construction begins so that inspections are conducted in a timely manner. The department should not grant program benefits to those applicants who fail to comply.

Response: Partially agree. ICIP is an "as-of-right " program and benefits cannot be denied where the applicant has met all statutory criteria for exemption. The Exemption Unit will continue to promote and encourage applicants to satisfy the notice requirements via electronic transmissions. The use of readily available technological resources has already significantly reduced the time the staff must devote to filing hardcopy documents so that more time can be devoted to analysis of substantive criteria for eligibility. This requirement is not statutory and is not an appropriate basis for denying as of right benefits.

Recommendation 8: Preliminary inspections of all properties being considered for program benefits are conducted immediately following an applicant's notification of the construction commencement date:

Response: Partially agree. While we will rely on the assessors for inspections when needed, we will also continue to work closely with the assessors and to take advantage of readily available materials on the Department of Buildings website to monitor the progress of ICIP construction projects.

Recommendation 9: Inspections are conducted and reports submitted to the Exemptions Unit in a timely manner.

Response: See Response to Recommendation #8

Recommendation 10: Ensure that certificates are submitted for all properties. In the event that certificates are not submitted, the Department should suspend program benefits for those properties.

Response: Partially agree. The Department has introduced State legislation that would make filing of certificates of continuing use a biennial, rather than an annual, event. This change will enhance the ability of the ICIP staff and the assessors to monitor applicants' compliance with industrial and commercial use requirements. While the Department is legally authorized to suspend benefits in such cases, the law

does not mandate suspensions. The Department prefers to avoid such drastic remedies in an "as-of-right" program.

Recommendation 11: Conduct a thorough review of an applicant's certificate-of-continuing-use, the inspection report, and other supporting documentation to determine whether a property remains eligible for program benefits.

Response: See Response to Recommendation #10

Recommendation 12: Conduct inspections of properties receiving ongoing benefits to verify that the property's use has not been converted to an ineligible use.

Response: Agree. We will continue to work with the assessors to insure that the applicants continue to use the benefited parcels for the exempt purposes that initially gave rise to the exemption and/or abatement benefits.

Recommendation 13: Suspend or revoke benefits of properties that do not comply with program requirements regarding continuing use. In particular, the Department should suspend or revoke the incorrectly granted benefits for those properties identified in this report and recoup those benefits.

Response: Agree. We will continue to revoke or reduce benefits, as required by law, upon discovery of changes to ineligible uses. We will also continue to revoke exemptions from the date of the prohibited use, with interest and penalty, as specifically mandated by the ICIP enabling laws.

Recommendation 14: Establish procedures to effectively administer the program and ensure that applicants are entitled to continue receiving program benefits. In that regard, the Department should ensure that applicants submit continuing-use certificates annually, and establish a tracking system to ensure that all applicants required to submit a certificate-of-continuing-use are sent a form.

Response: See Responses to Recommendations # 10, 11,12,13.

Recommendation 15: Suspend or revoke benefits when property owners do not comply with continuing-use requirements. In particular, the Department should suspend or revoke the incorrectly granted benefits for those properties identified in this report. The Department should also recoup improperly granted benefits to all properties that have not complied with continuing-use requirements.

Response: Agree. The Department will revoke benefits for changes in property use, where required by law. We will revoke benefits for application #6922, the only application that experienced a change in use that affected benefits granted.

Recommendation 16: Maintain appropriate documentation and certificates-of-continuing-use in Department files.

Response: Agree. The Department appreciates this recommendation and will make every effort to improve the maintenance of files.

Recommendation 17: Restore the adjudicated code violation check-off list to the certificate-of-continuing-use form.

Response: Agree. The CCU will be amended to require the applicant to certify under penalties of perjury that there are no adjudicated code violations on the subject property.

Recommendation 18: Ensure that applicants provide documentation to verify that a search for code violations has been conducted. Benefits should be suspended for properties that lack the required documentation.

Response: See Response #17

Recommendation 19: Implement adequate controls, as required by Comptroller's Directive 18, to ensure that program databases are complete and accurate.

Response: Agree. We agree that the accuracy and integrity of the program's database is of paramount importance. We are therefore taking action to enhance the database, as described more fully in Response #2.

Recommendation 20: Periodically reconcile the personal computer database and the mainframe database.

Response: See Response #2

CONCLUSION

The Department has administered the ICIP since the program's inception in 1984, a period in which the Department's actions and statutory interpretations have engendered rare instances of litigation by the real estate bar. The Department has been at the forefront of utilizing technology to improve the delivery of services as efficiently as possible. We are also vigorously promoting legislative initiatives that would greatly reduce the bureaucracy long associated with tax incentive programs. The Department's legislative agenda includes statutory amendments to the ICIP statutes. The proposals most relevant to the audit and its recommendations include the following:

- Consolidation of the application process so that only one application is filed. The application would be filed within one year of the issuance of the necessary building permits or, if the project does not require the issuance of construction permits, the application would be filed within one year of commencement of construction. Although this would provide much needed

administrative relief, the availability of information on the Internet would assure the program is administered fairly and consistently.

- CCUs would be filed biennially rather than annually. However, applicants who have converted any portion of their properties from industrial to commercial or to residential use would be required to file within a year of the conversion.

- Narrative descriptions of projects, cost estimates and expenditures, violation searches and construction start and completion dates would be subject to self-certification by licensed professionals.

- Completion documents would be available to applicants via a downloadable form on the Finance website where owners would self-certify the completion information and merely submit to the Department for processing.

- Self-certification by owners and licensed professionals would be subject to audit throughout the benefit period.

We firmly believe that these initiatives will serve to further enhance our ability to administer ICIP in a manner that successfully promotes the economic objectives of the program while upholding our fiduciary duty to the public to maintain the fiscal integrity of the program.

If you have any questions concerning this response, please call me at (212) 669-4878.

Sincerely,

Michael Koslow
Audit Coordinator

cc: Martha E. Stark, Commissioner, Department of Finance
Rochelle Patricof, First Deputy Commissioner, Department of Finance
Dara Jaffee, Acting Assistant Commissioner, Legal Affairs

APPENDIX

The Audit did provide valuable information regarding two properties where there was a change in use.

Application #6922

History: This Brooklyn property is located in an area that has been designated for ICIP purposes as a "special commercial exemption area" although the property was issued a certificate of eligibility for manufacturing activity, providing an exemption period of 25 years. The property is now completing the fifth year of the exemption period. The applicant has filed certificates of continuing use, affirming that a minimum of 75 percent of the building's floor area has been devoted to manufacturing activities. Based upon these representations by the applicant corporation's President, the property has received industrial benefits. On May 20, 2005, a site inspection by a DOF assessor confirmed the Audit's finding that less than 75 percent of the building is used for manufacturing activities.

Statutory provisions: Paragraph (a) of RPTL §489-gggg provides that a property receiving industrial ICIP benefits has converted to commercial use but is located in a special commercial exemption area, such property "shall continue to receive an exemption for industrial construction." However, this provision of the statute also requires that any abatement benefit must be terminated as of the date such property was converted to commercial use. RPTL §489-jjjj provides that the interest imposed from the date the taxes would have been due but for the industrial abatement granted will be calculated at an interest rate three percentage points greater than the applicable interest rate imposed by the City for non-payment of real property taxes.

Result: Although the property's industrial use has fallen below the 75 percent statutory threshold, the exemption will not change due to the property's location in a special commercial exemption area. The property did, however, receive inappropriate abatement benefits for fiscal years 2003/04 and 2004/05 as a result of the applicant's false representations. The Department will now impose these taxes and the interest accrued based upon the statutory provision described above.

Application #7581

History: A preliminary certificate of eligibility for manufacturing activity was issued for this Queens property providing a 25-year exemption benefit beginning in fiscal year 2000/01. This property is located in a regular commercial exemption area. As with the previous property, the owner consistently represented that the entire building has been and continues to be used solely for manufacturing purposes.

Statutory provisions: Paragraph (b) of RPTL §489-gggg provides that when a recipient of a certificate of eligibility for industrial construction work in a regular exemption area converts the property to commercial use, the exemption shall be reduced to that of a commercial property in a regular exemption area. A major difference between an

exemption authorized for industrial construction work and the exemption for commercial construction work in a regular exemption area is that the latter excludes positive equalization assessment increases.

Result: A tax assessor inspected the site on May 20, 2005 and, despite the lack of cooperation by the owner of the property, the assessor was able to confirm that less than 75 percent of the building is now used for industrial purposes. Because there were no positive equalization assessment increases imposed on this property since its initial exemption year, no excessive exemption benefits have been granted. However, the Department will revise the database to reflect the property's more limited tax exemption benefit due to its conversion – it will have a fixed exemption base of $11,440. As the property did not qualify for a tax abatement, no adjustment in tax liability for prior years will be necessary.

Given the substantial remedial authority granted to the Department by the statutes, we appreciate the additional information uncovered by the Audit. However, it should be noted that the Audit's projected revenue losses as a result of changes in use have been greatly exaggerated. The one actual instance of a property wrongly receiving tax abatement benefits, in the amount of $34,660.26, will be collected with interest plus the statutory three percent penalty.