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ERIE COUNTY LEGISLATURE

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County of Erie

NANCY A. NAPLES
COMPTROLLER

February 1, 1999

Erie County Legislature
25 Delaware Avenue
Buffalo, New York 14202

Subject: Audit of the PILOT Program of the ECIDA in conjunction with the Real Property Unit of the Erie County Division of Budget, Management & Finance.

Dear Honorable Members:

The audit response jointly issued by the ECIDA and the Division of Budget, Management & Finance (memorandum dated November 30, 1998, attached) is not in compliance with the County's Audit Response System and Procedures and, therefore, not acceptable.

Specifically, the response does not address two procedures:

1. Concurrence or lack of concurrence with the audit recommendations. If the department does not concur with an audit recommendation, the reason must be explained. If the department agrees with the audit finding but does not concur with the Comptroller's recommendations, an alternative course of action to effectively address the finding must be specified. *Audit Response System and Procedures 5. b.*

2. Actions taken and actions proposed to address audit findings/recommendations. Action already taken should be outlined. Actions to be taken to implement audit recommendations must be specified. If no action has been or will be taken concerning particular audit findings/recommendations, the reasons must be clearly indicated, and they must be reasonable (e.g. disagreement on findings, benefit/cost considerations, resource limitations, more effective alternative, etc.) *Audit Response System and Procedures 5. c.*

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Following are comments directed to the inaccuracies and misstatements made in the audit response jointly issued by the ECIDA and the Division of Budget, Management & Finance:

- **Background Section**

ECIDA/Finance Department Response:

The findings reported by the Comptroller represent only one interpretation, not necessarily the right interpretation which we believe is the one used by the ECIDA and Finance.

Auditor's Comment:

There were differences noted between the ECIDA and the amounts billed by Finance. As the chart on page 5 of the report indicates there were numerous differences. It was inappropriate for the responding parties to net the financial impact. The audit provided complete detail to the ECIDA and Finance of these differences. (*Note*: as it relates to these findings we did not determine if either the amounts per the ECIDA or Finance were correct. The audit findings highlighted the differences between the ECIDA and Finance records.) For example:

- For 1996 while there is a net difference of $4,391 of PILOT detail records that do not agree (between the ECIDA and Finance), the difference is actually for 87 PILOTS, including some PILOTs where the amounts due per the ECIDA database are greater than the amounts billed on SFG by a total of $355,136.87 and other PILOTs where the amounts billed per SFG are greater then the ECIDA database by a total of $359,527.96.

- For 1995 there is a net difference of $120,226.28 for 75 PILOTS, including some PILOTs where the amounts due per the ECIDA database are greater than the amounts billed on SFG by a total of $216,307.48 and other PILOTS where the amounts billed per SFG are greater then the ECIDA database by a total of $96,081.20.

These were all separate discrepancies and do not offset.

ECIDA/Finance Department Response:

The background section of the audit cites the adopted budget variances for the years 1995-1998. This is beyond the audit scope. . . To compare actual results of collection versus an adopted budgeting ignoring the adjusted budget and implying a criticism for exceeding budget is incomprehensible. . . Exceeding the annual revenue budget is an example of conservative budgeting practice and aggressive billing and collection procedures.

Auditor's Comment:

Reference to the adopted budget is not beyond the audit scope. The fact that the ECIDA is not broken out separately in the budget is relevant background information. Secondly, criticism for exceeding the budget is not "incomprehensible". Excesses in the range of 43% to 79% for each year reflects a failure to budget appropriately and is a means to purposely hide a surplus. This under budgeting, on a cumulative basis for the four year period, has needlessly inflated the tax levy by $7.5 million.

There is no justification for under budgeting to this extent because there are contractual amounts due for each PILOT. The number of PILOTs is known, based on all the PILOT agreements in place as of the tax status date. Although the exact amount due could not be determined prior to setting the applicable tax rates, a reasonable estimate of the tax rate could be used for calculation of the anticipated PILOT amount due.

- **Finding # 1 Comparison of ECIDA/County Real Property Unit Records**

ECIDA/Finance Department Response:

When these facts are considered, the differences amount to less than 1%. The ECIDA and Finance, as noted above, are in constant contact with each other resolving these issues.

Auditor's Comment:

The audit identified that not all differences are resolved. Significant outstanding differences are summarized on the chart on page 5 of the report. Additionally, as indicated in the Audit Summary of the report, we noted 60 PILOT billings/adjustments for 22 entities for a total of approximately $250,000 which were made during the course of the audit. These differences would not have been identified nor corrected without the initiation of the audit.

- **Finding # 3 No Formal Procedures**

ECIDA/Finance Department Response:

The statement included in the audit report that "no formal procedures as to how new PILOT agreements or the current amount due of established PILOT agreements are to be communicated to the County Real Property Unit"(P. 7) is not correct.

Auditor's Comment:

Formal procedures (i.e., documented procedures as in an operations manual) do not exist. Procedures should define a clear delineation of the processing steps and individual responsibility and should include the required documentation to be prepared and maintained, steps for review and approval, and specifically how and what information needs to be coordinated between ECIDA and Finance. No such procedures are documented at either the ECIDA or Finance.

ECIDA/Finance Department Response:

The assertion (P.3) that "neither party shares their calculation with the other" is untrue. The overwhelming proof of the effectiveness of this collaboration is that a net difference of $4,319 was noted on P5 in 1996 of the PILOTS that were billed.

Auditor's Comment:

Again as reflected above, for 1996 while there is a net difference of $4,391 of PILOT detail records that do not agree, the difference is actually for 87 PILOTS with certain PILOTs where the amounts due per the ECIDA database are greater than the amounts billed on SFG by a total of $355,136.87 and other PILOTs where the amounts billed per SFG are greater then the ECIDA database by a total of $359,527.96.

- **Finding # 4 Penalties and Interest for Late Payments Not Always Assessed/Collected**

ECIDA/Finance Department Response:

In all cases the policy of Finance is to give 30 days to pay without penalty whether from the initial billing date or from a correcting billing date.

Auditor's Comment:

The Report reflects identified late payments (greater then 30 days from billing date) in which appropriate penalties and interest were waived. The penalties and interest should have been assessed in accordance with the respective PILOT agreement and General Municipal Law (GML). Again, under GML the County Real Property Unit does not have the legal authority to waive penalties and interest.

ECIDA/Finance Department Response:

As another example of the complexity of the entire PILOT billing process, the draft audit report cited $36,600 as the amount of interest and penalties to be collected. Upon Finance's request for the details, the Division of Audit & Control supplied a report totaling only $27,768.31.

Auditor's Comment:

The difference from the $36,600 in the DRAFT report to the final report was not an interpretation issue, but as previously explained to the Finance Department, when the detail was provided, a footing error in summarizing the 59 of 66 non-assessed penalties and interest.

- **Finding # 5 Late PILOT Billing**

ECIDA/Finance Department Response:

The fact that the Division of Audit and Control took 16 months to audit two years of PILOT billings speaks volumes to the complexity of the procedure.

Auditor's Comment:

The 16 months to complete the audit was a reflection of:
- Significant inconsistency between ECIDA and Finance records
- Incorrect information provided (ECIDA database with incorrect tax rates)
- Inaccurate/incomplete Finance records (undocumented changes/discrepancies on Dbase file)
- Lack of cooperation (Finance not readily responding to questions)

- **Finding # 6 Accounts Receivable**

ECIDA/Finance Department Response:

The assertion in the audit report that "as of June 9, 1998 there was approximately $1.3 million in unpaid 1996 and prior years PILOTS. Additional PILOT amounts outstanding for these entities for 1997 and 1998 total approximately $410,000" is grossly misleading and sensationalistic. . . The true amount of ECIDA PILOT non-payment, which is actually available for collection, is reduced to two projects, AC Hamilton and ER Industries totaling $18, 643.87.

Auditor's Comment:

All amounts included in the report were outstanding accounts receivable as of June 6, 1998. Whether collectable, company in bankruptcy, repayment plan, out of ECIDA title, etc, the fact remains that a "contractual amounts due" per the respective PILOT agreement were unpaid and included in accounts receivable.

- **Finding # 7 NFTA Improperly Identified as having a PILOT Agreement**

ECIDA/Finance Department Response:

The question arises why this finding is an ECIDA PILOT audit.

Auditor's Comment:

The audit covered the PILOT program of the ECIDA in conjunction with the Real Property Unit of the Erie County Division of Budget, Management and Finance. The NFTA was identified in the Finance records as a PILOT, yet no amounts were recorded in the accounts receivable. This warranted inclusion in the report to highlight the outstanding amounts as well as awareness to the need for legal action to be taken to collect all due and proper outstanding amounts.

We request your Honorable Body to call to action the ECIDA and the Division of Budget to comply with the County's Audit Response System. Until such response is received and evaluated, we request your Honorable Body to keep both the Audit and the ECIDA and the Division of Budget's November 30, 1998 response on the Legislature Finance & Management Committee agenda.

Very truly yours,

Nancy A Naples

NANCY A. NAPLES
County Comptroller

Attachment

c: Hon. Dennis T. Gorski, County Executive
Mr. Kenneth C. Kruly, Director, Budget, Management & Finance
Mr. Ronald W. Coan, Executive Director, ECIDA
Mr. Greg Gach, Senior Budget Consultant, Budget, Management & Finance

County of Erie

DENNIS T. GORSKI
COUNTY EXECUTIVE

DIVISION OF BUDGET, MANAGEMENT AND FINANCE

KENNETH C. KRULY
DIRECTOR

November 30, 1998

The Honorable
Erie County Legislature
25 Delaware Avenue
Buffalo, New York 14202

Honorable Members:

Attached please find the ECIDA's and the Division of Budget, Management and Finance's response to the Payment In Lieu of Taxes (PILOT) Program audit conducted by the Comptroller's Office for the period January 1, 1995 to December 31, 1996, dated November 1998.

Very truly yours,

RONALD W. COAN, Executive Director
ECIDA

KENNETH C. KRULY
Director of Budget & Management
County of Erie

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RESPONSE TO THE COUNTY COMPTROLLER'S AUDIT OF THE PAYMENT IN LIEU OF TAXES (PILOT) PROGRAM OF THE ERIE COUNTY INDUSTRIAL DEVELOPMENT AGENCY (ECIDA) IN CONJUNCTION WITH THE REAL PROPERTY UNIT OF THE ERIE COUNTY DIVISION OF BUDGET, MANAGEMENT & FINANCE (FINANCE)

BACKGROUND

During the sixteen months May 1997 through August 1998, the Division of Audit and Control conducted a program and financial audit of the ECIDA and Finance. The audit scope included the years 1995 and 1996 and involved review of ECIDA financial management, financial controls and appropriateness of expenditures. In addition, the audit scope included a review of the ECIDA PILOT program and its collection and administration by Finance. No interim findings were provided to the parties previous to issuance of the draft audit report on August 18, 1998.

During the period under examination (1995 and 1996) ECIDA and Finance managed in accordance with their specialized roles over $6,000,000 of PILOT obligations. The actual dollar value of these projects equals nearly $1,800,000,000 and involves nearly 400 separate business corporations and nearly 450 distinct PILOTs. The ECIDA Board of Directors approved these PILOTs over the 1971 through 1998 period; the audit report did not limit its conclusions to the 1995-1996 period, as the report suggests. While the period of actual tax abatement usually occurs between seven and fifteen years, with many of the PILOTs involving NO property tax abatements, the Lease Agreement with the corporation will last for the life of the Industrial Revenue Bonds, twenty to twenty-five years, and upon expiration of the PILOT Agreement the corporation will pay a PILOT payment equivalent to "as if owned".

Simply put, there is no "standardized" PILOT which existed over the twenty-seven year period. In response to changing circumstances and economic conditions, modifications to New York State law, and increased experience and expertise in PILOT issuance, there is a bewildering variety of PILOT Agreements, which have accumulated over the years. The PILOT Agreement before 1991 usually, but not always, did not specify a fixed dollar amount, but instead relied upon a complex set of formulas, which must be recalculated each year. Since 1991, the PILOT formula was simplified and today is a percentage of the assessed taxes, but that percentage of assessed taxes varies from year to year. Therefore, PILOT administration, involving a considerable number of transactions that must be recalculated annually, is not an easy matter. In particular, the PILOT formulas, particularly those issued before 1986, can be interpreted and calculated in several ways and therefore do not lend themselves to a single "right" answer. The findings reported by the Comptroller represent only one interpretation, not necessarily the "right" interpretation which we believe is the one used by the ECIDA and Finance.

The background section of the audit cites the adopted budget variances for the years 1995-1998. This is beyond the audit scope. This budget item includes revenue generated by all IDA entities in the County not just the ECIDA. As stated on P. 5 of the audit a total of $3,463,767 ECIDA PILOTs were billed by Finance in 1996, the adjusted budget in 1996 was $3,737,249 and an adopted budget of $2,875,174. To compare actual results of collection versus an adopted budget ignoring the adjusted budget and implying a criticism for exceeding budget is incomprehensible. Is this a criticism for exceeding the adopted budget? If this is the case the criticism can be extended to the Office of the Comptroller as for the same period 1995-1997 the adopted budget of Interest Earnings has been exceeded by a total of $9,108,401, an annual average of $3,036,133. Instead of criticizing the Office of the Comptroller we have always applauded their effort in maximizing County revenue much in the same way Finance in concert with the ECIDA and all other IDAs in the County has maximized PILOT revenue. Exceeding the annual revenue budget is an example of conservative budgeting practice and aggressive billing and collection procedures.

PILOT administration is not an exact science and each year the ECIDA and Finance work together to arrive at a common understanding of the various formulae and to ensure timely payment of the PILOT by the business firms. Unlike other IDA's that both collect PILOTs from the corporation and remit them to the County, the ECIDA does not bill or collect the payments. Finance assumes the later functions. Given the number of annual reconveyances and the large volume of PILOT transactions, dialogue is constant and at least weekly. New procedures are regularly instituted to deal with daily situations. The following constitutes the combined comments and responses to the Audit Report by both the ECIDA and Finance.

FINDING 1. COMPARISON OF ECIDA/COUNTY REAL PROPERTY UNIT RECORDS

All active pilots cited in Attachment I have been billed. The audit report noted a total of $164,929 on the ECIDA database that were not on Finance's database and a total of $101,692 on Finance's database not on the ECIDA's for a net difference in billing of $63,237 out of a total of $6 million in billings, a difference of approximately 1%. Two agreements cited, August Feine & Sons and Enidine Inc. are still being researched, as the appropriateness of the billing is still in question. In addition, Attachment I cites $46,222 in expired PILOTs that were not billed, stating that the "PILOT agreement expired with resulting regular taxes not assessed due to title to the property not timely conveyed (transferred) back to the company from the ECIDA". One of the properties cited, Bennett Manufacturing, was conveyed timely and property taxes were paid for the year cited. The other properties were transferred after the taxable status date and under New York State Real Property Tax Law it is the responsibility of the individual town assessors to adjust properties that have an exemption that they are no longer entitled to, Section 520. When these facts are considered, the differences amount to less than 1%. The ECIDA and Finance, as noted above, are in constant contact with each other resolving these issues.

FINDING 2. INCORRECT PILOT BILLINGS

The twelve agreements cited in Attachment II have been researched based on the work papers provided by the Division of Audit and Control. Five of the agreements cited have been recalculated, correctly billed and collected in full. Of the remaining seven we disagree with the Division of Audit and Control's findings. Again, as stated above, these differences can be attributed to complex contract language and its interpretation. The Division of Audit & Control has their opinion and the ECIDA in concert with Finance has their opinion of the correct billing. This interpretation problem will always exist until the older PILOT Agreements expire. This is not a problem with the PILOT Agreements drafted since 1991, which are more standardized and much less prone to different interpretations. The two Rosina Food Products agreements are simply a matter of an overbilling offsetting an underbilling.

This is also a problem with property tax assessment in general. In 1997, Finance had processed over $2.7 million dollars in tax adjustments. An open item in the Legislatures Finance Committee facilitates processing of these corrections. Adjusted PILOT billings are a fact just as adjusted property tax billings are. It is not a question of making a mistake, as it is a matter of interpretation and proceeding with the best available information at the time of billing.

FINDING 3. NO FORMAL PROCEDURES

The statement included in the audit report that "no formal procedures as to how new PILOT agreements or the current amount due of established PILOT agreements are to be communicated to the County Real Property Unit" (P. 7) is not correct. As noted above there is constant communication between the ECIDA and Finance. This inter-agency communication relies upon the rather detailed requirements of notification and administration specified by State law with which both parties are in compliance (no violations or notification in the administration of NYS IDA law are indicated in the report). General Municipal Law requires that (1) within fifteen days of closing, a copy of the PILOT Agreement is sent to the Chief Elected Official of each taxing district; (2) Finance receives an application for real property exemption (Chap 372) from the issuing IDA. In addition, the State Comptroller requires an Annual Report no later than April 30th.

Given the reality that many PILOT formulas can be calculated in several ways, elaborate dialogue occurs to arrive at a mutual understanding and agreement on the final annual PILOT amount, which is then sent by invoice to the corporation. Other than specifying that such a dialogue should occur, there is no way a written formal procedure could simply and clearly address all the variables considered. The assertion (P.3) that "neither party shares their calculation with the other" is untrue. The overwhelming proof of the effectiveness of this collaboration is that a net difference of $4,319 was noted on P 5 in 1996 of the PILOTS that were billed. The net difference between properties not listed on ECIDA and Finance databases was only $40,087 out of a total of nearly $3.5 million PILOT Agreements. The standardization of PILOT Agreements that began in 1991 is addressing the issue of what should be billed. As noted above, since that point in time the amount to be billed has been expressed as a percentage of assessed taxes, but that percentage varies from year to year. It is still subject to the assessment, controlled by the individual tax assessor, and a tax rate that is calculated after the County budget is passed.

FINDING 4. PENALTIES AND INTEREST FOR LATE PAYMENTS NOT ALWAYS ASSESSED/COLLECTED

As noted above the PILOT Agreements in question relate to a period covering 1971 through 1998 and there is no standard PILOT Agreement. Consequently the penalties for late payments range from nothing, to penalties specified by Real Property Tax Law, to late payment penalties that are contractual only and not covered by Real Property Tax Law but by General Municipal Law Sec 874, which specifies 5% plus 1% a month beyond the first month. In all cases the policy of Finance is to give 30 days to pay without penalty whether from the initial billing date or from a correcting billing date.

This is in compliance with Real Property Tax Law Sec. 930 that is specific to utility tax billing but has been applied to PILOT billings as the nature of the situation is similar. As another example of the complexity of the entire PILOT billing process, the draft audit report cited $36,600 as the amount of interest and penalties to be collected. Upon Finance's request for the details, the Division of Audit & Control supplied a report totaling only $27,768.31. This report is being researched to determine if the correct penalty was collected or not.

FINDING 5. LATE PILOT BILLING

Again, as noted above there is no standard PILOT Agreement and in many instances billing of the agreement depends on an interpretation and a gathering of information from various sources. Most of the information necessary to compute a PILOT billing is not available until late December and in some instances early January. Finance begins gathering assessment information in September when School Tax Rolls are prepared. However, assessments are open to challenge and tax rolls for

County/Town tax purposes are not finalized until late December. County tax rates are dependent upon final adoption of the County Budget that in some years stretches to the second week in December. Once this information is available the PILOT billing process begins. It is safe to say that it is easier to bill $600 million in combined County/Town Tax bills to almost 350,000 parcels than it is to bill $4 million to 300 plus parcels. Once the initial PILOT billings are individually computed the bills are printed and sent out giving thirty days for payment as cited above.

The fact that the Division of Audit and Control took 16 months to audit two years of PILOT billings speaks volumes to the complexity of the procedure. It is not a simple process and to penalize the corporations is unfair. The sound business practice of giving them 30 days to pay regardless of the date of the calendar is both fair and in compliance with Real Property Tax Law Sec. 930.

FINDING 6. ACCOUNTS RECEIVABLE

The assertion in the audit report that "as of June 9, 1998 there was approximately $1.3 million in unpaid 1996 and prior years PILOTS. Additional PILOT amounts outstanding for these entities for 1997 and 1998 total approximately $410,000" is grossly misleading and sensationalistic. Attachment III of the audit lists 12 projects, out of over 300 possible, totaling nearly $1.7 million of accounts receivables. The list, however, cites projects like the Buffalo Airport Center (Westinghouse Building) which is the subject of several court actions and which has involved a series of public and non-partisan solutions, all of which would recover outstanding PILOT obligations when the final disposition of the property is resolved. The Westinghouse Building is nearly 65% of the $1.7 million accounts receivable findings of the audit. A special session of the County legislature was called on November 13, 1998 to accept a payment plan that will result in this entire amount being collected within three years. In addition, two of the projects (40 Gardenville Corp and Tooling Enterprises have paid since 6/9/98. Four of the projects (Terminal of Commerce, Graphics Arts Supply, Payments Plan and Prudential Building) are currently in bankruptcy court and subject to a court determination yet to be made. Dynamic Enterprises is out of ECIDA title and along with Days Inn are paying the County and all other taxing districts in accordance with a payment plan negotiated among the various taxing districts. Quo Vadis has been researched and the billing adjusted for an assessment reduction resulting in no balance being due. The true amount of ECIDA PILOT non-payment, which is actually available for collection, is reduced to two projects, AC Hamilton and ER Industries totaling $18,643.87. Both of these are not a material deficiency given the 450 ECIDA projects that total nearly $1.8 billion dollars.

FINDING 7. NFTA IMPROPERLY IDENTIFIED AS HAVING A PILOT AGREEMENT

The question arises why this finding is included in an ECIDA PILOT audit. This billing by Finance is coded in the GOVERN tax receivable system as a PILOT billing. It is covered by Public Authorities Law Sec 1299-r, Chapter 43-A of the Consolidated Laws, Article 5-Public Utility Authorities, Title {13} 11-A- Niagara Frontier Transportation Authority. Specifically it states: "If the authority owns or acquires property and all or any portion of such property is subsequently developed, improved or used for non-transportation purposes, it shall during such period of disuse for transportation purposes be subject to assessment, at the prevailing method of determining assessments based upon the current assessed value of all or the relevant portion of such property by the appropriate assessing unit and the authority shall, based on such assessment, annually, **in lieu of taxes**, pay such amount to the municipal corporation and/or school district." This PILOT receivable was coded to be included in the PILOT receivable account. It would have been counter productive to code it as anything but this.

As stated in the audit report the NFTA is challenging the appropriateness of this law and billing. Finance has had discussions with the NFTA about this and was told that they would not pay it. These discussions predate the PILOT billing and relate to the taxable assessment done at the town level and property tax billing done by Finance. Removal of the property from the tax rolls is a function of the town assessor not the County nor the ECIDA. This matter is being referred to the County Attorney as to what legal remedies are open to the County to collect these amounts as the law as supplied to Finance did not include any remedies available to it.