ALAN G. HEVESI
COMPTROLLER

110 STATE STREET
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

March 16, 2004

Mr. Robert W. Walsh, Chairman and
Members of the Zone Administrative Board of the
North Shore Empire Zone
110 William Street
New York, NY 10038

Re: North Shore Empire Zone
Report 2003-D-5

Dear Mr. Walsh and Members of the Board:

One of the Office of the State Comptroller's primary objectives is to identify areas where local governments can improve their operations and provide guidance and services that will assist local officials in making those improvements. Our goals are to develop and promote short-term and long-term strategies to enable and encourage local government officials to reduce costs, improve service delivery, and to account for and protect their government's assets.

In accordance with these goals, we conducted a New York City-wide study to assess the effectiveness of the Empire Zone Program (Program). Specifically, the study focused on whether zone officials are designing and modifying goals to achieve measurable results, implementing systems to monitor and evaluate performance, and whether goals are being achieved and the expected benefits received. Our review focused primarily on 1999 through 2002 data. The North Shore Empire Zone was one of the three zones included in this citywide study.

This review, conducted pursuant to Article V, Section 1 of the State Constitution, and further authority vested in the State Comptroller by Article 3 of the General Municipal Law, provides observations and recommendations specific to the North Shore Empire Zone. However, because the Program is primarily State-funded and administered at the local level, some recommendations for Program improvement will be directed to the Legislature and State officials in a statewide report. Consequently, the statewide report should be used in conjunction with this report to obtain a comprehensive understanding of the Program.

Background

Empire Zones are designated areas in the State that offer tax benefits and incentives to encourage economic development, business investment, and job creation. Pursuant to General Municipal Law §956 (GML), the goal of the Program is to create jobs and stimulate private investment in new or existing businesses in order to alleviate problems in impoverished areas of the State. To be eligible for zone designation, a sponsoring locality (city, county, village, or town) must meet certain criteria, many of which are measures of poverty, unemployment, and economic distress. There are currently 72 designated zones, 10 of which are located in New York City. Zone Administrative Boards are responsible for establishing goals, developing objectives to achieve the goals, establishing zone boundaries, and monitoring and evaluating zone performance. The Commissioner of New York City's Department of Small Business Services (Department) serves as the Chairman of the Zone Administrative Board for each of the City's zones and the Department oversees the activities of the zones. A zone coordinator administers the Program on a day-to-day basis, pursuant to a contract with the New York State Department of Economic Development (DED) which administers the Program at the State level.

To receive certain benefits, such as a sales tax refund, a business needs only to reside within the boundaries of a zone. However, other benefits are dependent upon a business receiving "zone-certification." This generally entails increasing, or at least maintaining, jobs and/or investing in a business. To become certified, a business must submit an application to the zone's certification officer documenting what projected job creation or investment will occur. The zone and the State jointly certify the application. Once certified, a business can also receive additional benefits, such as a sales tax exemption, by applying for Qualified Empire Zone Enterprise (QEZE) status. To maintain the QEZE status, a certified business must meet an annual employment test requirement. In addition, New York City offers the Industrial and Commercial Incentive Program (ICIP). The ICIP provides for partial exemption of taxation for eligible industrial and commercial buildings which are constructed, modernized, rehabilitated, expanded, or otherwise physically improved.

The North Shore Empire Zone (Zone) was established in 1994. The City of New York is the sponsoring locality along with the County of Richmond (Staten Island). In total, 110 certified businesses in the Zone reported that they invested over $32 million in 2002 and received over $2.3 million in tax benefits. The Zone coordinator also reported that 3,178 jobs were created and 6 new businesses were established in 2002. This information, which was reported by the businesses and compiled by the Zone coordinator, is not independently verified.

In 1999, the Zone initiated a for-profit Zone Capital Corporation which was operational in 2000. The Commercial and Industrial Capital Corporation (CICC) is the first for-profit Zone Capital Corporation in New York State. Capitalized at $2 million, the CICC provides loans to Zone-certified businesses.

A preliminary version of the matters discussed in this report was provided to Zone officials for their review and feedback. We have considered their comments in preparing this report.

Results of Study

The North Shore Zone Administrative Board (Zone Board) has established goals that align with the Legislative intent of the Program and the goals are specific and sufficiently measurable to assess whether they are being achieved and whether benefits are realized. However, the Zone's monitoring and evaluation system is deficient in some respects. As a result, many Zone businesses reported performance shortfalls, yet no action was taken by the Zone Board against these businesses. The following is more specific information to support our overall observations, as well as other areas of improvement identified during our fieldwork.

Program Administration

One of the most important functions of the Zone Board is to develop and modify Program goals and objectives and periodically assess performance by measuring outcomes. This is commonly referred to as performance measurement. Performance measurement focuses on determining how well a program accomplishes what it is intended to and provides accountability over government services by comparing results against expected outcomes and resource allocations.

To effectively manage the Program, the Zone Board needs to develop specific, measurable, and quantifiable goals and objectives that align with the Program's intent. The initial zone designation application identifies the Zone's short- and long-term goals, the objectives to implement the goals, and procedures for evaluating performance. In addition to the long- and short-term goals and achievements, subsequent annual plans should include specific objectives and tasks which will be performed to address the Zone's goals.

Goals provide guidance to officials responsible for implementing the Program and ensure a common understanding of what is supposed to be accomplished. Furthermore, clear and quantifiable goals, with accompanying benchmarks, allow the Zone Board and other interested parties to assess whether goals were met and outcomes achieved. For example, the Zone Board may determine that it wants to create 1,000 new jobs in the community and will annually measure job placements in the census tract and unemployment rates in the geographic region as ways to gauge Program success. By periodically assessing performance, the Zone Board can determine whether goals and objectives need to be modified.

DED has recognized that each Zone needs to be managed locally to address the unique situations affecting it. Areas of the State and New York City have different attributes for attracting businesses and different demographic and economic issues. These issues make it impractical to use a uniform Program model. As such, Zone Boards have been provided significant flexibility with the manner in which they can establish goals and objectives. However, the enabling legislation also stipulates specifically what the intent of the Program is and consequently what the State expects to receive from the Program costs. Based on the GML, the intent of the Program is to create jobs and stimulate private investment in new or existing businesses in order to alleviate problems in impoverished areas of the State.

Our review disclosed that the Zone Board has established goals relating to attracting new businesses and expanding existing businesses. In 2002, the Zone reported that it attracted six new

businesses. In addition, the Zone has made three boundary revisions, all of which are in line with the goals of the Zone. The 1995 revision was to provide space for the attraction of a new business to the State. The 1997 revision was to remove undevelopable land and add commercial and industrial areas. The 2002 revision was for the retention of existing businesses that were to either add employees and/or make investments.

Most of the Zone's goals are quantified and achievement of the goals can be measured. Furthermore, the Zone is generally achieving its goals. However, some of the goals are outdated. For example, one primary goal is to designate a high tech district in St. George and another goal is to develop a Women and Minority Business Enterprise (WMBE) program. Both goals were achieved in 2000 and, therefore, should have been discontinued as goals in subsequent years.

In addition, the Zone's designation application did not contain a sufficient evaluation plan to assess Zone performance and the Zone Board has not established such plans. For example, the evaluation plan contains output measures including: the number of firms expanding within the Zone; the number of jobs created by expansion; and the number of firms and jobs moving into the Zone. The Zone also collects other data on a monthly basis, including, the amount of CICC loans given out, real estate deals made, the number of WMBE businesses assisted and the amount of government procurement contracts they received. However, outcome measures that are relevant to the Program, such as reductions in unemployment rates (the Zone does obtain monthly unemployment statistics, but these are for the entire borough of Richmond, not just the Zone); poverty rates, dependence on public assistance income, or vacant industrial and commercial space, are not included. The use of such outcome measures would focus Zone efforts and allow officials to determine whether Program goals are achieved and whether the Program accomplishes what the legislation intended it to.

Monitoring, Evaluating, and Enforcement Procedures

DED's Rules and Regulations provide that the Zone certification officer and the Commissioners of Labor and DED can jointly revoke the certificate of a business (i.e., decertify the business) for a variety of reasons, including the failure of the business to create new employment or prevent the loss of employment. However, the Zone does not have a system in place to address such performance shortfalls by Zone businesses receiving benefits and the Zone coordinator stated that they would not decertify a business for failing to meet its goals. The fact that 12 (29 percent) of the 41 Zone businesses that we reviewed reported having fewer employees in December 2002 than they had when they filed their applications, underscores the importance of having a system in place to address performance shortfalls.

Annually, businesses participating in the Program submit a business annual report (BAR) to the Zone that includes, among other information, job, investment, and selected tax data. The Zone compiles this information along with other Zone activity information and files a Zone Annual Report (ZAR) with DED. Neither the Zone Board nor the Zone coordinator has requested information from the New York State Department of Taxation and Finance and Department of Labor to verify job, investment, and tax data reported on the BARs. (Department officials claim they requested this information through DED, but were told that it wasn't available.) Furthermore, they have not taken other steps within their control, such as contacting the businesses for additional supporting documentation, to verify the reported data. Zone officials stated that BAR information is an

attestation by the business and the Zone does not have the resources to verify such data. Further, the Zone coordinator does not believe that the Zone has the authority to ask businesses for supporting documentation. Consequently, the Zone coordinator is relying on businesses to let the Zone know how they are performing and how much the Program is costing and benefiting taxpayers without any assurances as to the accuracy and completeness of reported data.

Job Creation

To analyze job creation performance, we compared the businesses' projected job creation identified on their applications to "actual" job creation reported on the BARs for a judgmental sample of 50 of the 118 certified businesses in the Zone in June 2003. Of the 50 businesses selected, 41 submitted BARs, 5 did not file a BAR, and 4 either moved or closed. Our analysis of performance by the 41 individual businesses that submitted BARs shows that only 8 businesses (20 percent) reported that they met or surpassed their projected job growth. The remaining 33 businesses reported reducing staffing (12 businesses), not adding any jobs (7 businesses), or not adding enough jobs to meet their projected job increases (14 businesses). Overall, the 41 businesses projected adding 649 full-time and 214 part-time jobs, but fell short of the full-time job goal by about 580 jobs, while exceeding the part-time job goal by about 88 jobs, as shown in the following table:

Years Certified	Number of Businesses	Projected Job Growth Per Years Certified		Actual Job Growth		Jobs Over/(Short) of Projected Growth	
		FT	PT	FT	PT	FT	PT
Over 2	28	595	197	(27.0)	170.00	(622.0)	(27.00)
1 – 2	13	54	17	96.5	131.75	42.5	114.75
Totals	41	649	214	69.5	301.75	(579.5)	87.75

In total, the 41 businesses added 69.5 full-time and 301.75 part-time jobs. This means that the businesses achieved only 11 percent of the goal for full-time jobs, but 141 percent of the goal for part-time jobs.

Six of the businesses that reported they lost jobs also reported that they claimed QEZE tax benefits totaling $15,600. Since these benefits are directly tied to increasing or at least maintaining jobs, this performance shortfall is of particular concern. It is possible that the tax benefits reported on the related BARs were not accurate, which should be investigated, or the businesses may have improperly interpreted the BAR instructions. (We provided this information to Department of Taxation and Finance officials for their review.)

Zone Investment

To analyze investment performance, we compared projected investment identified on the business applications to "actual" investments reported on the BARs for the 50 certified businesses selected above. The business applications identify the amount of investment to be made and the expected start and completion dates of each investment. The business applications for 30 of the 50 businesses identified projected investments totaling $61,478,570 between January 1, 1999 and

December 31, 2002. (The other 20 businesses did not include projected investments in their applications.) We compared this projected investment to the investments they reported on the BARs for the same time period (the BARs were available for all four years for 22 of the 30 businesses). We found that overall, the 22 businesses reported total investments of $26,952,551, which was only 50% of the $54,247,510 projected investment level. Eleven of the 22 businesses reported that they exceeded their projected investment by $2,094,284, while the other 11 businesses fell short of their projections by $29,389,243.

Cost-Benefit Analysis

By performing cost-benefit analyses, the Zone Board could determine whether taxpayer dollars are used efficiently and effectively. Such an analysis of estimated costs and benefits, prepared prior to certifying a business, could protect against situations where a business receives tax benefits that exceed the benefits provided to the community. Subsequent cost-benefit analyses of certified businesses could help prevent such situations from continuing. In addition, periodic Zone-wide cost-benefit analyses could assist the Zone Board in determining whether the Program is operating efficiently and effectively.

As was previously mentioned, the reported BAR data is not verified by using third-party data. In addition, the Zone reports that it is not able to collect job pay rate data or the volume of benefits provided under the ICIP because the New York City Department of Finance does not keep such data for Zone businesses. The Department obtains data on utility discounts provided to businesses, but this is not broken down by individual business. Therefore, the Zone does not have sufficient data to perform a complete cost-benefit analysis. Most importantly, Zone officials do not perform cost-benefit analyses either Zone-wide or for individual Zone businesses.

We did not attempt to conduct Zone-wide cost-benefit analyses because of inadequate data maintained by the Zones and in most cases we were unable to conduct individual business cost-benefit analyses because of similar limitations. For example, the BAR requires that total gross payroll and total employees be reported, but does not require that payroll attributable to the new employees be identified. As such, individual cost-benefit analysis using BAR information can only be conducted in situations where all employees are new. We reviewed BAR and summary spreadsheets of BAR information and identified four Zone businesses for which we could readily conduct a cost-benefit analysis. In these cases, the benefits these businesses provided the community through increased payroll and investments exceeded the State and local tax benefits they received by more than $19 million for 2002. These businesses reported receiving tax benefits of $600,397 for employing 75 full-time and 125 part-time persons who were paid a total of $2,082,255 and making investments totaling $17,523,902.

Due to the fact that ICIP benefits and utility discounts are not broken down by business, they were not included in our cost-benefit analysis. It is also important to note that the cost-benefit analysis for 2002 may not capture all costs because the BAR does not include State sales exemptions, reduced utility costs, or local tax savings that may be received by businesses.

The Department also has not formally analyzed the cost-benefits of the Program in the New York City zones. Department officials informed us that they had several informal analyses

compiled, but do not consider them sufficiently reliable to utilize.

Zone Annual Reports

Each zone is required to submit a Zone Annual Report (ZAR) to DED. We found inconsistencies in how Zone officials complete parts of the report, especially Attachment B, which summarizes important performance data for the Zone including: the number of jobs created and retained by certified businesses; the number of new businesses created in the Zone; the number of businesses retained in the Zone; and the total amount of private capital leveraged with public funds. Most of the data for Attachment B is taken from the BARs submitted by the Zone certified businesses. Examples of the deficiencies we noted are as follows:

- The Attachment B instructions for calculating jobs created by certified businesses state that full-time and part-time jobs reported on the BARs should be added together. However, the BAR captures total employment figures, not the number of jobs created during the year. Therefore, Attachment B should instruct the zones to subtract employment at the beginning of the year (per the prior year's BAR, or for new businesses, from the application), from year-end employment per the current BAR. In the 2002, the Zone reported 3,178 jobs created, without subtracting jobs existing at the beginning of the year. Based on data compiled by the Zone, the number of jobs reported on the BARs totaled 3,209.5. Zone officials could not explain the difference between what they compiled and the number reported. However, they told us that they strictly followed the ZAR instructions. Therefore, the reported number of jobs created is greatly overstated. We did not review all the BARs from the prior year, so we cannot evaluate how much this number is overstated. However, in the 2001 Annual Report, the Zone reported that 2,672 jobs were created. If the 2001 Annual Report is correct, the reported jobs created in 2002 may be only 506 jobs.

- Similar inconsistencies were noted in the reporting of private capital leveraged with public funds. Attachment B says to "Include equity investments made by EDZ certified businesses in cases where they received state or local financing assistance. Also include direct equity investments in EDZ-certified businesses supported with the use of zone capital credits." In 2002, the Zone reported $35,611,025 as the amount of private capital leveraged with public funds. Based on data compiled by the Zone, the amount of investments reported on the BARs totaled $32,135,506. The Zone appears to have included all investments reported on the BARs, whether a tax credit was claimed or not. Zone officials could not explain the difference between what they compiled and the number reported and did not provide documentation to support the amount reported in the Annual Report. According to DED officials, the ZAR should include equity investments and any zone infrastructure investments in an area such as an industrial park, that result in businesses being attracted to that park and making investments. However, they noted that the data is not obtained from the BARs. Therefore, the zones should have a separate mechanism to capture and track this amount.

Recommendations

1. Develop a complete and comprehensive written evaluation plan that addresses all aspects of performance measurement and Program administration. This should include establishing clear, quantifiable, and measurable current goals and objectives

that use outcome measures and benchmarks.

2. Establish and implement comprehensive performance measurement and evaluation systems. If necessary, request assistance from DED to establish such systems.

3. Improve monitoring and evaluation systems to address control deficiencies. At a minimum this should include developing specific job creation and investment criteria for certifying a business and annually comparing BARs to applications.

   (Zone officials believe DED should provide the zones with guidance on Program evaluation.)

4. Institute a system to address performance shortfalls by Zone businesses. Initiate de-certification procedures for businesses with recurrent performance shortfalls.

   (Zone officials don't believe this recommendation meets the spirit of the Program. They stated that businesses' job creation and investment projections could change for legitimate reasons.)

5. Pursue agreements with DED, the State Department of Taxation and Finance, and the State Department of Labor to obtain necessary information to verify the accuracy of the data reported by individual businesses. If such agreements cannot be negotiated, develop other systems to verify reported data. Data discrepancies should be investigated to ensure that data reported by the businesses to the Zone is accurate.

   (Zone officials stated that BAR information is an attestation by the business and the Zone does not have the resources to verify such data. Further, the Zone coordinator does not believe that the Zone has the authority to ask businesses for supporting documentation.)

6. Conduct cost-benefit analyses to help ensure that individual businesses are not certified if it would result in those businesses receiving tax benefits that significantly exceed the benefits provided to the community.

7. Perform an annual Zone-wide cost-benefit analysis to assess Program effectiveness and efficiency.

8. Ensure that the data necessary to determine Program costs and benefits is collected. At a minimum this should include the number of jobs created and the pay rates of those jobs. If the Zone Board determines that improvements should be made to the Business Annual Report to facilitate the collection of this data, it should work with DED to modify the current report format accordingly.

9. Obtain clear instructions from DED on how to complete the Zone Annual Report.

   (Zone officials stated that DED has formed a committee that includes local zone officials to examine the data reporting problems.)

We would appreciate receiving your response to the recommendations made in this report within 30 days, indicating any action planned or taken to implement them. We also wish to express our appreciation to the management of the North Shore Empire Zone for the courtesies and cooperation extended to our staff during this review.

Very truly yours,

Frank J. Houston
Audit Director

cc: Jay Anderson, Zone Coordinator