

H. CARL McCALL
STATE COMPTROLLER



A.E. SMITH STATE OFFICE BUILDING
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

February 24, 1998

Mr. Charles Gargano
Commissioner
Department of Economic Development
One Commerce Plaza
Albany, NY 12236

Re: Report 97-F-37

Dear Mr. Gargano:

According to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law, we reviewed the actions taken by the Department of Economic Development (DED) officials as of December 3, 1997, to implement the recommendations in our prior audit report 95-S-78. The prior report issued on May 23, 1996, examined the Department's efforts in overseeing the Economic Development Zone Program.

Background

In 1986, the New York State Legislature amended the General Municipal Law to establish the Economic Development Zones (EDZ) program. The purpose of this program is to stimulate economic growth in areas of New York State characterized by persistent and pervasive poverty, high unemployment, limited job creation, a dependence on public assistance, abandoned industrial and commercial facilities, and shrinking tax bases. The EDZ program attempts to stimulate economic growth by promoting the development of new businesses and the expansion of existing business through tax credits and other incentives.

Article 18-B of the General Municipal Law authorized the designation of up to 40 economic development zones between July 30, 1986 and December 31, 1995. In 1987 and 1988, 19 areas were designated as economic development zones; in July of 1994, the remaining 21 zones were designated. To be designated as an economic development zone, an area must be characterized by poverty, unemployment and general economic distress according to the most recent census data. In the original legislation, zones were designated for a period of 10 years. The legislation was amended in 1996 to continue all zones until 2004. The 1996 legislation was also enacted to create up to seven new zones in areas impacted by military base closures or defense contractor cutbacks. These zones are expected to be designated in early 1998.

Under the EDZ program, businesses that move to or stay in economic development zones may be granted reductions in their State taxes through an expanded investment tax credit, tax credits on wages paid to new employees (especially new employees who were unemployed or receiving public assistance) and a refund on the State sales tax paid for materials used in building or expanding business property. The municipalities in the zones are encouraged to provide local incentives and utilities provide reduced rates to zone businesses. In September 1997, about 2,300 businesses were certified to participate in the EDZ program.

The EDZ program is overseen by Empire State Development (ESD). ESD is responsible for designating areas as economic development zones, developing the procedures for certifying businesses as eligible for tax credits and other incentives, monitoring the activities of the certified business, and evaluating the success of the EDZ program in accomplishing its objectives. A total of five staff at ESD are dedicated to the EDZ program. In addition, ESD, the Department of Labor and the local zone are jointly responsible for certifying businesses as eligible for tax credits. The Department of Taxation and Finance is responsible for administering relevant tax credits and refunds. Each economic development zone is also administered by local officials that are jointly funded by ESD and local governments.

In 1991, in response to several audits that were critical of program administration and effectiveness, the Economic Development Zone Review Commission was established to determine whether the EDZ program should be continued. The Commission recommended that the program be continued, but stressed that certain improvements were needed if the program was to accomplish its objectives. In 1993, many of the Commission's recommendations were incorporated in an amendment to the General Municipal Law, including requirements that a system be established for evaluating the effectiveness of the EDZ program, that program benefits be compared to program costs and that the program be evaluated by an independent entity.

In 1997, DED contracted with an independent consultant group, Program Evaluation Management and Research, Inc. (PEMRI), to perform a cost-benefit analysis of the EDZ program, and to develop an evaluation system to compile and analyze information for periodic assessments of the program's accomplishments. The final report was due in August 1997, however, due to a difficulty in obtaining certain critical data from several state agencies, an extension was granted until September, but the final report was not available when we completed the follow-up review in December 1997.

Summary Conclusions

In our prior audit, we found that DED officials had not taken actions needed to determine whether the EDZ program was effective nor had they developed a system for doing so. We identified weaknesses in DED's monitoring of progress in the zones relative to creating and retaining jobs. We also noted problems regarding the decertification of businesses. Additionally, DED was not able to obtain information from the Departments of Labor and Taxation and Finance that would be needed to verify employment claims, to calculate program costs, and to ensure that tax credits were provided

only to eligible businesses.

In our follow-up review we found DED officials have contracted with a consultant to develop a system for evaluating program effectiveness. However, at the time of our follow-up review they had not completed their report. DED officials have made improvements regarding the decertification of businesses. They have also made some improvements in program monitoring but additional improvements are necessary.

Summary of Status of Implementation

Of the twelve prior audit recommendations, DED officials have fully implemented three recommendations, have partially implemented eight recommendations and have not implemented one recommendation.

Follow-up Observations

Recommendation 1

Implement a system for evaluating the effectiveness of the EDZ program.

Status - Partially Implemented

Agency Action - In January 1997, DED officials contracted with Program Evaluation and Management Research, Inc. (PEMRI) to conduct the legislatively mandated independent evaluation of the EDZ program. One objective of the contract is for PEMRI to develop in consultation with DED and the Department of Labor an evaluation system capable of compiling and analyzing accurate and consistent information necessary for an assessment of whether the statutory objectives and criteria of the program are being met.

The final report was to be completed by August 31, 1997. Due to delays in receiving some information requested from the Department of Labor the deadline was extended to September 30, 1997. At the time of this follow-up review, DED officials had received a draft copy of the report and it was being reviewed internally.

Auditors' Comments - The final report was not available for review. Therefore, we could not assess the system developed by the contractor. DED officials should ensure an evaluation system is in place in order to evaluate the program's effectiveness and to justify its continuation, reduction or expansion.

Recommendation 2

Ensure that the EDZ program's effectiveness is evaluated by an independent entity as required by Law.

Status - Partially Implemented

Agency Action - As noted above, DED contracted with PEMRI to conduct the legislatively mandated independent evaluation of the EDZ program.

Auditors' Comments - We could not assess the evaluation performed by the contractor since the report was not finalized and the draft report was not made available for our review.

Recommendation 3

Implement a system for determining whether the benefits of the EDZ program exceed the costs of foregone taxes and program expenditures.

Status - Partially Implemented

Agency Action - DED officials indicated this is one area that PEMRI will address. PEMRI will assemble information on the costs and benefits of the program. On the cost side, PEMRI will collect data on the number and value of each of the types of revenues forgone by the State and localities. They will also collect data on the sales tax refunds issued by the Department of Taxation and Finance. PEMRI will also seek information on the energy and telephone abatements received. They will also factor annual State and local program expenditures into the calculations.

On the benefits side, the consultant will collect data on the number of job changes statewide. They will also look at the number of targeted employees who are employed. The consultant will be able to calculate the following: cost per job created or retained, the leverage of public contributions to private investment, and the statewide multipliers of the EDZ program.

Auditors' Comments - The contractor's final report had not been issued and was not available for review.

Recommendation 4

Ensure that all economic development zones submit reports showing the progress made in achieving the goals included in their annual plans.

Status - Partially Implemented

Agency Action - DED officials indicated they have established a review and evaluation procedure which they conduct before awarding administrative grant funds to each zone. A zone's Yearly Program Plan for the upcoming year and its record of past performance is reviewed. Each zone is evaluated and the awarding of funds is based on this review. Officials also indicated they have instituted semiannual Statewide Coordinators meetings and regional

Advisory Committee meetings as an additional means of monitoring.

DED officials also indicated they modified the contract language to allow them to delay payments to zones if they failed to supply the required reports. Language of this type was added to the 1995/96 and 1996/97 contracts. They have also standardized all required reports and have provided all zones a schedule of when the reports are due.

Auditors' Comments - DED officials gave us a report dated September 8, 1997. This report indicated that 15 zones had not yet submitted to DED their year end progress report which were due July 15, 1997. We also noted that some of these zones had not submitted other required reports some of which were due as early as January 15, 1997. We reviewed documentation to determine if the Department withheld any payments due six sampled zones. We found four zones (Yonkers, Binghamton, Rome and Brookhaven) were all paid, even though all reports had not been submitted. The other two zones (Buffalo and Potsdam), did not submit requests for funding therefore they were not paid. Department officials should adhere to its procedure and expand it to include zones that do not request funding, to ensure zones submit all required reports in a timely manner.

Recommendation 5

Ensure that the economic development zones are visited regularly and the results of the visits are documented.

Status - Partially Implemented

Agency Action - DED officials provided copies of their Zone Site Procedures, a listing of the zone site visits conducted in 1996 and 1997 and sample copies of their zone site visit reports. Officials also indicated that in addition to the site visits, staff meet with zone coordinators at Zone Coordinator Advisory Committee meetings held around the State. They have established five such committees statewide. They also meet with all zone coordinators semiannually at statewide Zone Coordinator Meetings.

Auditors' Comments - We reviewed the zone site visit data supplied for 1996 and 1997 and found that some zones have not been visited regularly. In 1996, 13 of the 40 zones were not visited. The data provided indicates that all zones were visited in 1997, however, 18 zones received only one site visit. DED officials should establish procedures to ensure all zones receive regular site visits.

Recommendation 6

Ensure that annual reports are submitted by each business participating in the EDZ program.

Status - Fully Implemented

Agency Action - DED officials provided data on the Business Annual Reports (BARs) due/received since 1994. The data provided was as follows:

<u>Year</u>	<u># Due</u>	<u># Rec'd.</u>	<u>% Rec'd.</u>
1994	983	958	97.5%
1995	1674	1669	99.7%
1996	2237	2021(1)	90.3%

(1) - According to DED officials, another 133 businesses will be decertified for failing to submit their BARs. This equates to a submission rate of 96.3%.

DED officials have a system in place for tracking submission of BARs and other reports due. DED officials indicated that businesses which fail to submit BARs are recommended for decertification.

Recommendation 7

Ensure that the annual reports submitted by the economic development zones are complete and accurate.

Status - Partially Implemented

Agency Action - Since the prior audit, DED officials reviewed the legislative requirements regarding the Zone Annual Report and have revised the report. The 1995 reports were received in May 1996 from all 40 zones. The reports were provided to PEMRI to develop evaluation criteria and a database program to aid in review of these documents. At the time of the follow-up review, PEMRI had not yet completed this process.

At our closing conference for this follow-up review, DED officials provided copies of procedures and a checklist that will be used by Program Associates to review the annual report. In addition, a draft section of the PEMRI report provided by DED staff, indicates that EDZ staff need to work with the Zone Coordinators to ensure complete and accurate data are reported.

Auditors' Comments - Since information contained on these reports can be used as a basis for evaluating the effectiveness of the program, DED officials must ensure the data reported are complete and accurate.

Recommendation 8

Decertify businesses that do not comply with their certification agreement.

Status - Fully Implemented

Agency Action - DED officials indicated that they have decertified 546 businesses. They decertified businesses for a number of reasons such as: changed ownership, merged, failed to submit BARs, not in the zone, out of business or voluntary. In addition, another 30 businesses are pending decertification.

Recommendation 9

Initiate decertification procedures for the 275 businesses identified by local zone administrators.

Status - Fully Implemented

Agency Action - DED officials decertified 251 of the 275 businesses cited in our prior audit. The remaining 24 businesses were not decertified as they subsequently complied with program requirements.

Recommendation 10

Document all decertification notifications sent to the Department of Taxation and Finance.

Status - Partially Implemented

Agency Action - DED officials indicated the Department of Taxation and Finance is notified when businesses are decertified. They also provided copies of the procedures used for decertifying businesses. A draft chapter of the PEMRI report provided DED staff indicates that they will maintain a database of decertified businesses.

Auditors' Comments - During our follow-up review, DED officials gave us a copy of a cover letter and a listing of decertified businesses which they had sent to the Department of Taxation and Finance. They also gave us a separate listing of businesses that had been decertified. We compared these listings and identified four businesses which had been decertified and found that they did not provide notification to the Department of Taxation and Finance. DED officials indicated they sent a copy of their entire database to the Department of Taxation and Finance and therefore, they notified the Department of Taxation and Finance. We contacted officials of the Department of Taxation and Finance. These officials indicated that the database was supplied as a result of an inquiry by one of their audit units. DED and Department of Taxation and Finance officials need to coordinate the sharing of this information to ensure that appropriate Department of Taxation and Finance officials receive notification of all decertified businesses. Without such notifications, businesses could obtain tax credits to which they are not entitled.

Recommendation 11

Ensure that the local administrative matching requirements are met by the economic development zones.

Status - Partially Implemented

Agency Action - DED officials indicated that applications for funding require a letter of commitment for an in-kind match and a resolution or letter of commitment for the cash match prior to contracts being finalized. Each application is reviewed to ensure all requirements are met. Since our prior audit, a DED official sent all grant program managers a memo reminding them of this requirement. DED officials also provided evidence that they denied funding to some zones that had not met the matching requirement. They also supplied copies of the procedures used by the program office for reviewing financial reports.

Auditors' Comment - As part of our follow-up review, we reviewed the procedures used by program office staff to review the quarterly zone funding requests. We also found that the Contract Management Unit staff did not have formal procedures for processing payments based on their review of financial reports. We reviewed a sample of six zones to determine if appropriate funding was provided. We did not find any of the problems noted in our prior audit. However, the Contract Management Unit should develop procedures for the review of financial reports and develop better coordination with the program office to ensure all requirements are met before processing payments.

Recommendation 12

Seek legislative authorization to obtain relevant employment and tax information maintained by the Department of Labor and the Department of Taxation and Finance.

Status - Not Implemented

Agency Action - DED officials have not sought legislative authorization to obtain relevant information from the Departments of Labor and Taxation and Finance. Officials have requested information from the Department of Taxation and Finance on which tax credits have been used by EDZ certified businesses. However, due to confidentiality statutes, the Department of Taxation and Finance will only report such data on a statewide aggregate basis. DED officials also provided a copy of the annual report produced by the Department of Taxation and Finance which shows business use of the tax credits.

DED officials indicated they have been successful in getting employment data from the Department of Labor for verifying the data gathered from the EDZs. However, the employment data is aggregate data and cannot be used to verify employment data as reported on the BARs.

Auditors' Comments - DED officials should seek legislative authorization to obtain relevant tax information maintained by the Department of Taxation and Finance. This information would be useful in calculating the total costs of the program and ensuring that tax benefits are provided only to businesses that take actions to improve the local economic conditions. The data could also be used to compare the effectiveness of the various zones.

DED officials should also work with the Department of Labor to determine if they can obtain data to verify the employment data reported by zone businesses on the BARs. DED officials indicated that as a result of the PEMRI study, they would investigate this issue.

Major contributors to this report were William Challice, Frank Russo, Aaron Fruchter and Thomas Kulzer.

We would appreciate your response to this report within 30 days, indicating any action planned or taken to address the unresolved matters discussed in this report. We also thank the management and staff of DED for the courtesies and cooperation extended to our auditors during this review.

Yours truly,



Carmen Maldonado
Audit Director

cc: Robert L. King
Fred DiMaggio
John Pjontek