



New York City Department of Consumer Affairs

License Fee Revenues

2010-N-1



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of State Government Accountability

July 11, 2011

Jonathan Mintz
Commissioner
New York City Department of Consumer Affairs
42 Broadway
New York, New York 10004

Dear Mr. Mintz:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of *License Fee Revenues*. This audit was performed pursuant to the State Comptroller's authority under Article V, Section 1 of the State Constitution and Article III of the General Municipal Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

*Office of the State Comptroller
Division of State Government Accountability*

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State of New York

Office of the State Comptroller

EXECUTIVE SUMMARY

Audit Objective

The objective of our audit was to determine whether the New York City Department of Consumer Affairs (Department) maximizes license fee revenue.

Audit Results – Summary

The New York City Department of Consumer Affairs (Department) is responsible for ensuring that consumers and businesses benefit from a fair and vibrant marketplace. The Department is authorized to issue licenses and permits for certain businesses operating in New York City and to collect associated fees. For the fiscal year ended June 30, 2010, the Department's revenue totaled \$30.9 million and consisted primarily of \$9.7 million in license fees, \$9.2 million in franchise fees, and fines totaling \$7.2 million. The Department issues licenses to more than 71,000 businesses in 55 business categories such as home improvement contractors, electronics stores, cigarette dealers, parking lots, and locksmiths. Depending on the license type, a license period is from one day to two years and full-term license fees range from \$10 to \$2,740.

We determined that the Department could likely generate additional revenue if it used better methods to identify businesses that operate without a required license. Our audit tests indicate that the Department's current methods - which rely primarily on street patrol and complaint investigation - are not sufficient to identify businesses operating without a license.

According to Department records, the licenses of approximately 11,600 entities had expired but had not been renewed during the period July 1, 2008 to December 31, 2009. We selected a judgmental sample of 89 store-based businesses and visited their previously-reported locations in June 2010. At seven locations, we found the same business activity underway-although the Department had no record of a current licensee for those activities. License fees for the seven businesses would have totaled \$2,320. If this level of unlicensed business activity exists throughout the population of 11,600 entities, it is possible that as much as \$300,000 in license fees has not been collected.

Moreover, Department records indicate that some businesses continue operating many years after their licenses have expired. We analyzed a database of the 3,915 violations the Department issued for unlicensed activity during the period July 1, 2008 to December 31, 2009 and identified

at least 1,884 businesses that were operating without renewed licenses. The licenses for 145 of these businesses expired between 1992 and 2007 – revealing a significant risk that these businesses had been operating, in some cases, for as long as 15 years after their licenses expired.

The Department needs to be more proactive in pursuing methods to identify businesses that operate without obtaining and paying for a license. One method the Department could employ involves matching its licensing database against information collected by the New York State Department of Taxation and Finance and the New York City Department of Finance. Both of these agencies require entities to not only report their business location, but also to identify the nature of their business activity using a six-digit North American Industry Classification System (NAICS) code. Because many of these codes are similar to the Department's license codes, a comparison between these databases could provide an excellent starting point for identifying various classes of businesses operating without a license.

Our report contains five recommendations directed at improving the Department's efforts to identify unlicensed businesses and improving the accuracy and completeness of information contained in the Department's licensing database.

This report, dated July 11, 2011, is available on our website at <http://www.osc.state.ny.us>.

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Office of the State Comptroller

Division of State Government Accountability

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Albany, NY 12236

Introduction

Background

The New York City Department of Consumer Affairs (Department) was founded in 1969. Its main purpose is to ensure that consumers and businesses benefit from a fair and vibrant marketplace. The Department enforces the City's Consumer Protection Law and other City and State consumer protection and licensing laws. The New York City Charter and Administrative Code authorize the Commissioner to issue licenses and permits for certain businesses operating in New York City and to collect the associated fees. The Department also has the authority to inspect businesses to ensure compliance with consumer protection requirements. As of April 2010, the Department had about 300 employees.

The Department's Licensing Unit is responsible for issuing licenses and permits and for collecting the associated fees. It issues licenses to more than 71,000 businesses in 55 business categories such as home improvement contractors, electronics stores, cigarette dealers, parking lots and locksmiths. Depending on the type of license, a license period may range from one day to two years and full-term license fees range from \$10 to \$2,740. The Department's Enforcement Unit conducts citywide inspections to ensure compliance with various laws.

For the fiscal year ended June 30, 2010, the Department collected \$30.9 million in revenue, including \$9.7 million in license fees, \$9.2 million in franchise fees, and fines totaling \$7.2 million.

Audit Scope and Methodology

We audited to determine whether the Department maximizes license and franchise fee revenue. Our audit scope covered the period July 1, 2008 through June 15, 2010. To accomplish our objective we reviewed relevant laws, rules, procedures and records including: applicable sections of the New York City Charter, the New York City Administrative Code, the Rules of the City of New York, City Comptroller Directives, the State Tax Law as well as North American Industry Classification System business codes.

We also examined procedure manuals, interviewed Department officials, observed the collection of license fee revenues, compared collections with the New York City Comprehensive Annual Financial Report for the year ended June 30, 2009 and made site visits to the former places of business for sampled licensees that did not renew their license to verify that they were no longer doing business at those locations. Further, we examined correspondence between the Department and New York City Department of Finance and New York State Department of Taxation

and Finance, and contacted these officials regarding the sharing of information submitted on tax and information returns.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As is our practice, we notify agency officials at the outset of each audit that we will be requesting a representation letter in which agency management provides assurances, to the best of their knowledge, concerning the relevance, accuracy and competence of the evidence provided to the auditors during the course of the audit. The representation letter is intended to confirm oral representations made to the auditors and to reduce the likelihood of misunderstandings. Agency officials normally use the representation letter to affirm that, to the best of their knowledge, all relevant financial and programmatic records and related data have been provided to the auditors. They further affirm either that the agency has complied with all laws, rules, and regulations applicable to its operations that would have a significant effect on the operating practices being audited, or that any exceptions have been disclosed to the auditors. However, officials at the New York City Mayor's Office of Operations have informed us that, as a matter of policy, mayoral agency officials will not provide representation letters in connection with our audits. As a result, we lack assurance from Department officials that all relevant information was provided to us during the audit.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article III of the General Municipal Law.

**Reporting
Requirements**

A draft copy of this report was provided to Department officials for their review and comment. We considered their comments in preparing this audit report.

Within 90 days of the final release of this report, we request that the Commissioner of the New York City Department of Consumer Affairs report to the State Comptroller advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented the reasons why.

**Contributors to
the Report**

Major contributors to this report include John Buyce, Frank Houston, Cindi Frieder, Albert Kee, Gene Brenenson, Irina Kovaneva, Menard Petit-Phar, Jean-Renel Estime, and Sue Gold.

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Audit Findings and Recommendations

Better Methods of Identifying Businesses that Operate without a License

In these tight fiscal times, it is particularly important for government agencies to ensure that businesses obtain any required licenses and pay the associated fees. Department officials explain that they identify unlicensed businesses primarily through investigations of complaints, as well as observations made by about 50 inspectors who conduct street patrols. These activities can be time-consuming and rely largely on the inspector's ability to note the existence of a licensable business. Because many businesses that the Department licenses do not always operate in commercial areas, their presence may not be readily observable by inspectors performing other routine duties. Home improvement contractors, salesmen, employment agencies, and pedicab drivers are examples of businesses that may be harder for inspectors to simply come across in the course of their normal activities.

As of April 29, 2010, Department records identified about 11,600 businesses whose licenses had expired between July 1, 2008 and December 31, 2009, but had not been renewed. We selected a judgmental sample of 89 store-based businesses and visited their previously-reported locations in June 2010. At seven locations, we found the same business activity underway-although the Department had no record of a current licensee for those activities. License fees for the seven businesses would have totaled \$2,320. If this level of unlicensed business activity exists for the population of 11,600 entities, it is possible that as much as \$300,000 in license fees has not been collected. While performing our observations in June 2010, we identified an eighth location where activity requiring a license was being conducted, without a Department license. The last license for this location had expired shortly before July 2008.

Moreover, Department records indicate that some businesses have continued operating for many years after their licenses expired. We analyzed a database of the 3,915 violations the Department issued for unlicensed activity during the period July 1, 2008 to December 31, 2009 and identified at least 1,884 businesses that were operating without renewed licenses. The licenses for 145 of these businesses had expired between 1992 and 2007 – revealing a significant risk that these businesses had been operating, in some cases, for as long as 15 years after their licenses expired.

Department officials explain that they notify licensees just before the end of the license period that their licenses need to be renewed, and send another notice after the license has expired. However, the Department

does not perform any other targeted follow up. Some locations may end up being visited when an inspector conducts annual street patrol inspections. In other cases, a location may be visited in response to a consumer complaint.

We believe the Department needs to explore better and more proactive methods to locate businesses that are operating without a license. Our audit identified actions the Department could pursue to improve its ability to identify such businesses and collect the fees they owe.

The New York State Department of Taxation and Finance (State Tax) and the New York City Department of Finance (City Finance) each compile information on businesses operating within New York City. Many of the forms submitted to these agencies require entities to identify not only their location, but also the nature of their business activity using a six-digit North American Industry Classification System (NAICS) code. For example, entities must report such codes on their State tax returns, on forms requesting a Certificate of Authority to collect sales tax, as well as on several City Finance forms. Because many of the NAICS business activity codes are similar to Department license codes, a match with these databases could provide an excellent starting point for identifying businesses operating without a license. For example:

- Department license code 034 for employment agencies is similar to NAICS activity code 561300 for employment services.
- Department license code 122 for collection agencies is similar to NAICS activity code 561440 for collection agencies.
- Department license code 100 for home improvement contractors is similar to NAICS activity codes 238110, 238120, 238130, 238140, 238150, 238160, 238170, 238190, 238210, 238220, 238290, 238310, 238320, 238330, 238340, 238350, 238390, and 238900, which each represent certain specialty trade contractors.

There are certain obstacles that the Department will have to overcome to begin implementing these comparisons. Officials from both State Tax and City Finance advised us that they are restricted in their ability to share information obtained on tax returns and other forms, and that current laws do not permit them to share this information with the Department. However, we note that each agency is permitted to release some information to certain other governmental entities, such as the Office of Temporary and Disability Assistance, the Commissioner of Jurors and the Secretary of the Treasury. Department officials need to consider seeking legislative changes that would enable them to access these records for the purpose of identifying unlicensed businesses. The

Department should also work with other government agencies, such as the Department of State, that capture information about the nature of business activity to seek access to similar data for comparative purposes.

Department officials do not agree that the use of NAICS codes to identify unlicensed businesses would be productive because there is little verification of the codes entered on these forms. While there may be some errors in the use of codes, a database comparison, once established, could provide an efficient and effective mechanism for identifying potential licensees for follow up. Further, our testing indicates that the Department's current methods - which rely primarily on street patrols and complaint investigations - are not sufficient to identify businesses operating without a license.

- Recommendations**
1. Investigate the eight unlicensed businesses identified in this report and collect the appropriate amounts of license fees and penalties due.
 2. Consider seeking legislation that permits the Department to obtain information from State Tax and City Finance about businesses that could or should have licenses.
 3. Be more proactive in developing methods of identifying businesses that operate without obtaining and paying for a license. These methods could include, but not be limited to, obtaining information from other State and City agencies that collect information on business activity.

**Accuracy
of Revenue
Information**

The Department records information about licensed businesses in the Citywide Agency Management Information System (CAMIS). We found this information is not always accurate.

Many businesses are required to provide their sales tax identification number when applying for a Department retailer license. The sales tax identification number and employee identification number fields are important because they could facilitate matching information with other agencies.

We reviewed the Department's fiscal year 2009 database for three license categories: electronics stores, home improvement contractors and general vendors. We found that sales tax and employee identification numbers are not always entered into CAMIS. This information was missing for 77 percent of the 2,962 electronics stores, 86 percent of the 10,198 home improvement contractors, and 27 percent of the 2,123 general vendors.

We reviewed the applications for 15 randomly-selected entities where this information was missing - five from each of the three categories. Although 13 employer identification numbers and 12 sales tax identification

numbers were provided on the 15 applications, Department employees had not entered any of this information into CAMIS. We also found instances where license expiration dates were incorrect.

One reason for these problems is that management has not clearly communicated to staff the information that must be entered into the Department's license database system. The Licensing Unit Cashier's Manual states that some data fields do not have to be entered for all licenses, but it does not provide staff with detailed instructions about which fields they must enter. The Department needs to better monitor entries into its database systems.

If important information is not entered or entered incorrectly into the Department's database, the Department may not have the information it needs to make informed decisions or to use its database to match information with that of other databases.

- Recommendations**
4. Clearly communicate to employees the information that needs to be entered into the Department's database systems.
 5. Monitor database entries to ensure that they are accurate and complete.

Agency Comments



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Commissioner

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May 13, 2011

Mr. John Buyce
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street - 11st Floor
Albany, NY 12236-0001

Dear Mr. Buyce,

The Department of Consumer Affairs (DCA) appreciates the opportunity to respond to the April 14, 2011, *Draft Audit Report on the Department of Consumer Affairs License Fee Revenues – 2010-N-1*.

At DCA we constantly strive to ensure that all of our operations are performed in an efficient and effective manner. We appreciate the time the NYS Comptroller's office dedicated to performing this audit. While we do not agree with all of the audit's conclusions, we are pleased the questions raised represent a small fraction of DCA's licensing fee revenue. Finally, we appreciate the courtesy and professionalism of your staff in the performance of this audit. If you have any questions or need further information, please contact Stephanie Hertz Kane, Director of Audit, at (212) 487-9678.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. Mintz', written over a horizontal line.

Jonathan Mintz
Commissioner

cc: George Davis III, MOO
Stephanie Hertz Kane, DCA
George Pape, DCA
Alba Pico, DCA
Marla Tepper, DCA

Response to Draft Audit on the Department of Consumer Affairs License Fee Revenues
2010-N-1
May 13, 2011

Based upon our review of the draft report, there appears to be a misunderstanding of critical aspects of the Department's operations with respect to the audit. We believe these concerns must be cleared-up to properly represent the relevant Department activities.

The number of issues discussed in the audit, range from questioned sampling methods to dramatic data changes between the preliminary and draft audit reports, and suggest that the auditors may not appreciate fully the varied nature of the Department's 55 distinct license categories, industry specific enforcement strategies, varied license regulations, and data capturing methods.

We are available to meet with the audit team to clear up these discrepancies.

Audit Findings and Recommendations

General Comments: There appears to be lingering confusion on the nature of DCA licensees and enforcement activity that creates continued questions about the auditors' review and assessment of enforcement activity for the 11,600 businesses whose license expired but had not renewed during the 18-month period (July 1, 2008 – December 31, 2009), including:

- Premise-based licensed activity is simply not the same as non-premise-based work, such as home improvement contracting. For these categories we only know the home address of the licensee, not where the licensee is working. Thus, there is just no such thing as an in-person, home inspection for those license categories. It not only would be inappropriate but also potentially unsafe for inspectors to visit residential neighborhoods and knock on people's doors. Instead these industries are regulated through investigatory sweeps, complaint based enforcement, in the field patrols and sting operations. Such licensees would not be performing activity that would require a license within their own home. Such licenses account for over 65% (7,622) of the 11,600 entities reviewed. As nearly two-thirds of the sample is invalid, the methodology for assessing adequate enforcement activity should be reexamined.
- DCA takes reasonable measures to ensure that businesses are not operating for extended periods of time without renewing their licenses. There is continuing confusion as to the extent of DCA's enforcement activity. Enforcement activity that did not result in a violation for unlicensed activity was not considered, nor was enforcement activity outside of the 18-month timeframe. For example, the Department inspected one business nine times between the license expiration in March 2003, and the violation for unlicensed activity issued in June 2010.
- The judgmental sample of 90 entities seems too small to make a projection of potential revenue lost, particularly given that this projection is based on 8 questionable cases. DCA was unable to locate 2 of the 8 entities on the full listing that DCA provided to the auditors. In addition, a review of the 6 entities allegedly operating without a license, found that all had enforcement activity performed after the expiration of their license. This indicates that DCA conducted proper follow-ups, and that the entities could not have been operating for the entire period used to calculate the estimate.

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* See State Comptroller's Comments, page 21

Response to Draft Audit on the Department of Consumer Affairs License Fee Revenues
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May 13, 2011

- There were significant changes between the preliminary draft audit, which found “356 entities that had not renewed on a timely basis”, and the subsequent draft report, which identified “at least 1,884 businesses that were operating without renewed licenses”. DCA did not receive an explanation of this increase and is thus unable to determine the accuracy or methodology used to arrive at this new number.

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Comment
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Recommendation #1: Investigate the eight unlicensed businesses identified in this report and collect the appropriate amounts of license fees and penalties due.

DCA Response: A thorough search for these entities resulted in a determination that six of them appear on the full listing of 11,600 businesses. For these six entities DCA’s Enforcement Unit performed inspections at each location after the license expired, noting the following activity:

- 2 entities were inspected multiple times resulting in violations when applicable
- 2 entities were inspected and found to be out of business
- 2 entities were inspected and not found to be conducting activity that required a license.

Recommendation #2: Consider seeking legislation that permits the Department to obtain information from State Tax and City Finance about businesses that could or should have licenses.

DCA Response: As noted in the audit, State Tax and City Finance will not release this type of information to DCA. Due to the fact that the North American Industry Classification System (NAICS) codes are self-selected, require no verification, and do not directly overlap with our license categories, DCA believes that this is not an effective or efficient method to locate businesses that require DCA licenses. Furthermore, DCA is confident that current efforts made by the agency are proactive and the best usage of agency resources.

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Comment
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Recommendation #3: Be more proactive in developing methods of identifying businesses that operate without obtaining and paying for a license. These methods could include, but not be limited to, obtaining information from other State and City agencies that collect information on business activity.

DCA Response: Indeed the Department is proactive in identifying unlicensed businesses, conducting over 50,000 inspections annually. We will continue these efforts as well as assess opportunities to further enhance such inspection activities

Recommendation #4: Clearly communicate to employees the information that needs to be entered into the Department’s database systems.

DCA Response: DCA will continue to clearly communicate to employees the information that should be entered into the Department’s database system. In fact, employees are regularly informed of the information that’s required to be entered into the database, and quality assurance checks are performed to ensure the information is accurately recorded. All additional information for the issuance of a license is securely stored in the licensee’s file.

*** See State Comptroller’s Comments, page 21**

Response to Draft Audit on the Department of Consumer Affairs License Fee Revenues
2010-N-1
May 13, 2011

Recommendation #5: Monitor database entries to ensure that they are accurate and complete.

DCA Response: DCA will continue to monitor data entries and perform quality assurance checks on data entered into the database.

State Comptroller's Comments

1. As clearly stated in the audit report, the objective of this audit was to determine whether the Department maximizes license fee revenue. Our objective was not to assess the Department's enforcement activities. In accordance with our audit objective, we identified additional steps to identify businesses operating without paying for a Department license. We are not confused about the nature of the Department's licensees do not physically work at the address that is listed on their license.
2. We understand there are challenges in inspecting licensees that conduct "non-premise-based" work. Our audit does not recommend that the Department perform in-person home inspections; rather we recommend that the Department implement additional procedures to identify businesses operating without paying for a Department license.
3. The audit report does not opine about the extent of the Department's enforcement activities. We analyzed the Department's database of violations for unlicensed activity and found at least 1,884 businesses operating without renewing their licenses. The Department needs to collect license fees from businesses that are required to pay them.
4. We made no statistical projection. We calculated a frame of reference to assist in understanding the potential lost license revenue. The objective of our audit test was to determine whether businesses that had not renewed their licenses might still be operating.

Regarding the two entities that officials were unable to locate on the Department listing, one, an electronics store, whose license expired on December 31, 2008, was on the listing. The license for the other expired shortly before July 1, 2008, and therefore was not on the listing. The report has been amended to reflect this change. Moreover, while the Department asserts they took enforcement actions, our observations in June 2010, identified activity requiring a Department license at these locations and the Department had no record of a current licensee for these activities.

5. On April 14, 2011, Department officials requested a listing of the 1,884 entities. We provided the list on April 15, 2011. On April 15, 2011, Department officials asked for the violation number for each of the 1,884 entities. We provided that information on April 20, 2011.
6. We continue to believe that the Department should explore additional methods to identify businesses operating without a required Department license and to collect associated fees. We maintain that the use of technology and database sharing are methods the Department should consider to achieve this goal.