Nassau County
Office of the Comptroller
Field Audit Bureau

Nassau County Comptroller’s Office
Financial Review
of
Assessment Review Commission’s
Tax Certiorari Liability Calculation

<u>**HOWARD S. WEITZMAN**</u>
Comptroller

MA04-03

July 30, 2004

NASSAU COUNTY
OFFICE OF THE COMPTROLLER

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Executive Summary

Background

Nassau County's Department of Assessment (Assessment) determines the assessed value of all properties in the county. The tax roll it establishes is used by the county, towns, schools and special districts for assessing real estate taxes. State and county laws provide administrative and judicial relief for taxpayers to redress their grievances with respect to unequal or excessive assessments. Administrative relief is granted through the Assessment Review Commission (ARC) which is empowered to correct erroneous assessments. Nassau County guarantees real estate tax revenues to the towns, school districts and special district that use its tax rolls. As such, when a property is determined to be over assessed, the county is responsible for refunding the real estate tax on behalf of all jurisdictions to the aggrieved individual or entity. Nassau County has paid approximately $1.1 billion dollars in refunds over the past ten years.

The county's Comprehensive Annual Financial Report (CAFR) includes recognition of the estimated liability for pending tax certiorari grievances each year end. The refunds paid, along with the increase or decrease in the estimated liability, are recognized as an expense on the county's financial statements. For example, the refund expense recognized in 2003 is $152 million, comprised of $112.5 million in refunds paid combined with a liability increase over the prior year of $40 million.

In past years the County Attorney's Office has provided liability estimates to the Comptroller's Office. This year, the liability was estimated by the Assessment Review Commission (ARC). The Nassau Interim Finance Authority (NIFA) and the Administration is monitoring ARC's reduction of the backlog of open grievances, which can be measured, in part, by the change in the year end liability.

In May 2004, the Comptroller's Office performed a review of ARC's methodologies and the assumptions used to estimate the liability as of December 31, 2003. ARC's liability estimate was $320 million; however, based upon the Comptroller's Office's audit procedures, we estimated that the liability is $365 million. The results of the review were summarized in a letter dated May 25, 2004, a copy of which is attached as Appendix 1. ARC issued a response to this letter (Appendix 2). The results of our review were presented to, and accepted by, Deloitte and Touche, the county's independent auditors.

Financial Review Scope, Objective and Methodology

This financial review was performed in order to ensure the reasonableness of ARC's tax certiorari liability estimate as of December 31, 2003 and prior to its inclusion in the 2003 CAFR. This review was conducted in accordance with generally accepted government auditing standards. These standards require that the review be planned and performed to obtain reasonable assurance that the tax certiorari liability estimate is free of material misstatements.

Executive Summary

Our review included examining documentation and other available relevant records that would substantiate the accuracy of the liability estimate calculation. We believe that the audit provides a reasonable basis for the audit findings and recommendations.

Summary of Significant Audit Findings

The tax certiorari liability is a major component of the County's long term debt and has been closely monitored by NIFA. As a result, ARC should have, but did not, maintained work papers and source data files so as to outline assumptions and document/substantiate calculations. Major components of the estimate, including the assessed values of properties with open writs, and interest and tax rate calculations could not be reproduced by ARC or traced back to its source data. Assumptions used by ARC to estimate refund liabilities for class 3 (utility properties) and class 1 (residential properties) were not supported by data that could be validated by audit.

ARC applied an average tax rate to the assessed value of properties grieved to determine the taxes paid on those properties, referred to as "tax dollars at risk". ARC factored the percentage of properties requiring reduction, and the average reduction required, against the tax dollars at risk to determine the refund liability. In the absence of verifiable calculations used by ARC to determine tax rates, we performed calculations using three methods and found the results consistent with each other, but inconsistent with the rates used by ARC. We found that ARC overstated average tax rates by about 16% for class 4 1985/1986 – 1995/1996 refunds and by 20% for 1985/1986 – 1995/1996 and 11% for 1996/1997- 2002/2003 class 2 properties (apartment buildings and certain condominiums). This tax rate overstatement caused significant overestimations of the tax dollars at risk. For example, approximately $2.0 billion in 1885/1986 – 2002/2003 class 4 (commercial properties) assessed values are being grieved. A 16% error would cause an overstatement of tax dollars at risk of $320 million.

We found that ARC substantially understated the interest liability for settlements related to 1985/1986 – 1995/1996. Taxpayer's are entitled to be paid interest on the taxes wrongfully over assessed. Interest is owed from the date of the original tax payment to the date the refund is paid. Interest rates from March 1, 1993 to March 7, 1999 were 5% annually and then were reduced to 4.5% beginning March 8, 1999. ARC's estimate of interest for the settlements related to 1985/1986 – 1995/1996 was only 14% for class 4 properties and 16% for class 2 properties. Any refund owed from these years would include at least eight years interest. We estimated the cumulative interest for this tranche to be about 42%, or $14 million higher.

ARC's estimate of required reductions was based upon opinions of value determined in anticipation of a possible ratio challenge. ARC appraisers valued a sample of approximately 350 properties and determined those that were entitled to reductions, and the reduction in assessed value required. We found that ARC did not validate its estimates of valuation by comparing them to actual settlements negotiated on sample properties. We obtained actual settlement information for both sample and non-sample properties. Based upon actual settlements we found that the average assessed value reductions used by ARC for the back years are reasonable as

Executive Summary

compared to actual settlements. However, for the tax year 2003/2004, the average reduction granted on class 2 property settlements was 24.49% (as compared to 19.90% determined by ARC) and 22.50% for class 4 properties as compared to 18.53% estimated by ARC. The application of actual settlement rates resulted in a $43 million increase in liability for class 2 and 4 properties.

While we generally concur with the methodology developed by ARC to estimate the refund liability, we believe revisions to the methodology for future year estimates may increase its accuracy. Further stratification of the estimate into individual tax years should provide a better understanding of the refund liability associated with each year. Each tax year grieved may represent a different level of exposure because each year's stipulation rate may be more or less favorable to the county than other years. Statistical information, derived from actual settlements for each year, detailing the percentage of parcels requiring reduction and the percentages of reductions granted, can be used to predict the potential assessed value reductions remaining in the open writs for each year. Additionally, yearly stratification will permit the use of the average tax rates for each year, rather than averages of multiple years. The estimation of refunds on a year by year basis would allow for a much more accurate calculation of interest liability. The interest owed on each years refund would then be calculated individually, from the date of tax payment to the date of the estimate.

Departments Response

The matters covered in this report have been discussed with officials from ARC during and at the conclusion of the audit. On June 22, 2004 we submitted a draft report to ARC officials with a request for comments. We received a written response from the Office of the County Attorney on July 26, 2004. The full text of the Office of the County Attorney's response, and our comments on the response are included as an addendum to this report.

TABLE OF CONTENTS

Findings and Recommendations

Inadequate Documentation of Liability Calculations

Audit Finding (1):

The liability estimate is presented annually in the CAFR and is closely monitored by NIFA and the Administration for debt issuance and planning purposes. In prior years the estimated liability was developed by the County Attorney's Tax Certiorari Bureau and was based solely on the judgment of the Bureau Chief. The estimate of the 2003 liability was calculated by the Assessment Review Commission using statistical sampling techniques. The reasonableness of this estimate is important in assessing the county's financial condition and projecting cash flow. ARC has not adequately maintain work papers and computer files documenting the balances of open writs, effective tax rates, and interest liability on refunds or provide support for assumptions regarding the percentage of reduction required for residential and utility properties.

The lack of documentation and version control of computer files significantly hindered our review. The following are examples of documentation weaknesses we encountered in the review of ARC's estimation of the tax certiorari liability.

The total assessed value of open writs represented ARC's starting point for determining the amount of tax payments subject to challenge. ARC provided auditors with worksheets that it prepared after accumulating the open writ data; however, it did not maintain copies of the assessor's data files from which the writ data was obtained. ARC received periodic updates of open writs from the assessor which replaced previous versions. Older versions were deleted when the updates were received. As a result, we could not verify ARC's open writ data back to the original source data.

Another liability estimate assumption factored into the calculation is property tax rates. The effective tax rates are used to calculate the tax dollars at risk, which represents the total taxes paid on each property for the tax years covered by open grievances. ARC's determined tax dollars at risk for class 2 and 4 properties by multiplying the total open assessed value grieved times the average tax rate. In order to enhance the accuracy of its estimate, ARC divided open writs into three tranches, 1985/1986 – 1995/1996, 1996/1997- 2002/2003 and 2003/2004. Tax rates have escalated over the past years and therefore ARC calculated separate average county-wide tax rates to be used for each tranche. While ARC presented two different calculations of the tax rates, neither calculation agreed to the rates it used for calculating the tax dollars at risk. ARC was unable to provide a documented calculation supporting the average tax rates it used.

Since the Comptroller's Office was not provided with ARC's average tax rate calculation supporting documentation, we estimated average tax rates utilizing data from three sources – (1) the Assessor Annual Report (specifically total tax levies for the years 1993 – 2003); (2) ARC's Parcels with Payments Analysis; and (3) Weighted Average Tax Rate data from IT Files.

Findings and Recommendations

The Comptroller's Office obtained year by year calculations of average tax rates prepared by ARC based upon total tax levies divided by total assessed values. It also obtained ARC's historical data showing reductions in assessed value granted for each year and the resultant tax refunds for each year. We calculated average tax rates for each tranche, using both of ARC's methods, along with a third method, but could not duplicate ARC's results.

The variation in calculations can be seen on the following table:

TAX RATE ESTIMATES

Tranches	Average Tax Rate Based on Annual Tax Levies*	Average Tax Rate Based on Parcels With Payments*	Average Tax Rate Based on Sample	Tax Rate Used by ARC
Class 4				
1985-1986 – 1995/1996	60.62%	60.80%	59.41%	76.00%
1996/1997 – 2002/2003	80.68%	80.38%	82.02%	83.00%
2003/2004	N/A	N/A	N/A	485.60%
Class 2				
1985-1986 – 1995/1996	63.03%	63.02%	62.13%	83.00%
1996/1997 – 2002/2003	80.49%	79.51%	81.96%	92.00%
2003/2004	N/A	N/A	N/A	466.52%

*Average tax rates based on annual levies were calculated using years from 1993 forward. Average tax rates based on refunds were calculated using years from 1991 forward. Liabilities related to earlier years would be negligible, and therefore the exclusion of earlier year tax rates and refund data in the calculation would enhance the accuracy of the estimate.

Given that the three calculation methods yielded consistent results, we applied a simple average of the three methods for estimation purposes.

The tax rate used is extremely important because the magnitude of the open assessed value creates great volatility in the estimate. For example, the open assessed value of class 4 properties for 1985/1986 – 1995/1996 was approximately $2.0 billion. Each percentage error in the estimated tax rate yields a $20 million difference in the tax dollars at risk. At ARC's estimated tax rate, the tax dollars at risk were $1.5 billion while at the rate determined by the Comptroller, the tax dollars at risk were $1.2 billion. At an average settlement rate of 5.98%, the resultant difference in the refund generates a difference of about $18 million.

Similarly, ARC was unable to provide a documented calculation supporting its calculation of interest owed on refunds. The interest owed is substantial in that it represents a liability of approximately $40 million. Due to the lack of documentation, we developed our own estimates of interest liability.

We found that ARC understated its estimate of interest owed on anticipated refunds for the settlement of 1985-1986 – 1995/1996 class 2 and 4 properties. Refunds on these year's tax roles are a minimum of eight years old. At an interest rate of 4.5% per year, cumulative interest would have to exceed 36%, even if all the refunds related to 1995/1996. ARC estimated cumulative interest at 14% for class 4 properties and 16% for class 2 properties.

Our calculations were based on a weighted average of actual tax refunds and the interest paid on the refunds for the years 1990/1991 through 1995/1996. (ARC did not have older data available, however; refunds related to earlier than 1990/1991 were minimal.) We then added an additional year's interest to represent the 2003 interest liability. Based upon this calculation, total interest was estimated to be about 42%. ARC's estimate of interest liability on this tranche was only $7.7 million where as the use of more reasonable estimated rates would have resulted in a liability of about $22 million.

Smaller components of the liability relate to writs filed on class 1 (residential) and 3 (utility) properties. ARC's underlying assumptions used for estimating the liability on these properties were not documented. For example, for class 3 properties, ARC estimated a liability of $9 million based upon the assumption that there are no grievances filed on two-thirds of the assessed values, and that the remaining one third of properties behave like class 4 properties with regard to settlements. ARC estimated the class 1 liability to be $10 million by assuming that 20% of the open assessed values would receive reductions and that the average reduction granted would be 10%. In either case, there was no auditable data presented to support these assumptions.

Auditors Recommendations:

ARC should maintain a complete set of work papers and computer files documenting its annual tax certiorari liability estimation process. A lead schedule should be prepared including all components of the estimated liability. Each component of the liability should be cross-referenced back to supporting schedules, calculations, computer files, or empirical data that fully document the balances and support the assumptions used in the estimation process.

ARC should determine appropriate methodologies for calculating average tax rates and interest liabilities. The methodologies should be documented and work papers containing the calculations should be retained so that ARC's conclusions can be substantiated.

Findings and Recommendations

Verification of Percentage Reductions

Audit Finding (2):

ARC's estimate of required reductions was based upon opinions of value performed in anticipation of a possible ratio challenge. ARC appraisers valued a sample of approximately 350 properties and determined those that were entitled to reductions and the reductions required.

The appraiser's estimates were not validated by comparing their valuations to actual settlements of properties included in the sample. The use of actual settlements brings a third party opinion into the estimation process because actual settlements are negotiated on an arms-length basis with the property owner or their representatives. A primary reason for increasing ARC's liability estimate from $325 million to $365 million was that ARC may have underestimated the percentage of reduction required for the 2003/2004 tax year. ARC's appraisers estimated that, for class 2 and 4 properties where reductions were required, reductions of 19.90% and 18.53% were required, respectively. These percentages were based upon estimated reductions required for 102 class 4 properties and 25 class 2 properties.

The Comptroller's Office reviewed actual reductions granted where settlements were reached during 2003 on the sample properties. However, the number of actual settlements was very low, with four of 25 class 2 properties and nine of 83 class 4 properties being settled. We decided to include settlements on properties other than those in the sample to try to validate the percentage assumptions used by ARC. We found that for 12 class 2 settlements, the average reduction granted was 24.49% and that for 58 class 4 settlements the average reduction granted was 22.50%. These differences between estimated settlements and actual settlements resulted in a $34 million increase in the estimated class 4 liability and a $9 million increase in the class 2 liability for 2003/2004.

Auditors Recommendations:

We recommend that future year estimates give consideration to actual ARC and County Attorney settlement experience and not rely solely on appraiser's estimates.

Findings and Recommendations

Methodology Revisions

Audit Finding (3):

ARC developed estimates based on calculations applied to only three tranches of open years. We believe that a greater degree of accuracy could have been achieved by calculating the liability for each year separately for the following reasons:

- Each tax year grieved may represent a different level of exposure to the county, depending upon how closely the stipulation rate for the year represents the actual ratio of assessed value to the fair market value of each class of property. Stipulation rates represent a ratio negotiated with the certiorari bar, and some years may be more or less favorable to the county than others. Actual settlement data, on a year-by-year basis, can be used to predict the potential assessed value reductions remaining in the open writs for each year.

- The average tax rate represents a blend of county, school and town taxes. Each taxing jurisdiction sets tax rates annually based upon the assessed values of properties within its boundaries and its budgetary requirements. The use of the average rates for each year, applied to estimated settlements for the corresponding year will result in a more accurate estimate than applying an average rate which represents the average of seven to ten year's tax rates. For example, the 1996 average tax rate for class 4 was 64.333%, while for 2003 that average rate was 98.491%, an increase of 53%. These large variations in tax rates will cause inaccuracies unless actual refunds are distributed evenly over the time periods averaged.

- The estimation of refunds on a year by year basis will allow a much more accurate calculation of interest liability

Auditors Recommendations:

ARC should consider tracking settlements for each individual year, including those settlements reached by the County Attorney. It should compile statistical information on the properties that were reviewed each year. Settlement data for each property should be accumulated, including data where reductions were granted, to determine the average reduction percentages and data where reductions were denied, to determine the percentage of properties requiring reduction. Statistical information based upon actual settlements could then be used to determine the remaining exposure contained in each year's open writs.

Average tax rates and interest owed on refunds should be calculated on a year by year basis and applied to the expected assessed value reductions for each year.

Findings and Recommendations

Anticipated Reduction in Liability

Audit Finding (4):

The estimated tax certiorari liability is not declining as expected. The estimated year end liability has been reported in the CAFR for the past six years as follows:

1998	$400 Million
1999	$400 Million
2000	$400 Million
2001	$400 Million
2002	$325 Million
2003	$365 Million[1]

- The trend above reveals that the reduction in liability begun in 2002 did not continue at the same rate in 2003. This may be the result of a flawed revaluation performed by CLT, which caused a 50% increase in the filing of grievances from 77,252 to 117,085.

After 2005, with the exception of $15million in 2006 and $10 million in 2007, the county will be required to fund real estate tax refunds out of its annual operating budget. The multi-year financial plan allocates $57.9 million per year for this purpose. Based on prior years' payments for outstanding liabilities, we estimate that the total claims backlog will need to be reduced below $231 million (plus permitted bonding) by December 31, 2005 in order to achieve the goals set forth in the financial plan.

Auditors Recommendations:

ARC should closely monitor the liability level and prepare projections of future liabilities. A proforma analysis format was devised for this purpose was provided to ARC and is attached as Appendix 3.

ARC should use this analysis to determine the feasibility of reducing the liability to levels that will enable it to meet the county's financial projections and the goals set by NIFA.

[1] Year 2003 includes $47 million in liability for class 1 properties arising from small claims assessment review. Prior year liabilities were provided by the County Attorneys' Office, and did not include the liability arising from SCAR proceedings. Refunds paid on SCAR proceedings averaged approximately $10 million per year from 1999 to 2003.

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Appendix 1

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To: Howard S. Weitzman, Comptroller

From: Manuel Mosquera, Deputy County Comptroller

Re: Estimate of Nassau County's Real Estate Tax Refund Liability (ARC Audit, Phase One)

Date: May 25, 2004

The Comptroller's Office has completed the first phase of its audit of the Assessment Review Commission (ARC). Specifically, we reviewed the methodology and overall reasonableness of ARC's calculation of the estimate of Nassau County's liability for real estate tax refunds as of December 31, 2003

Per our review and validation of ARC's methodology and the underlying data, we estimate the liability to be $365 million.

Nassau R.E. Tax Refund Liability – Comptroller's Estimate

	$ (in millions)
Back Years as of 12/31/02	$ 193.1
2003/2004	124.7
Small Claims Assessment Reviews	47.2
	$ 365.0

Using its methodology, ARC computed a real estate tax refund liability of $320.1 million. The difference in the two liability estimates results from our reliance on actual settlements reached for the 2003/2004 tax year, and the application of the percentage of reduction to all outstanding 2003/2004 claims. By contrast, ARC's approach relied on estimates of reductions generated by staff appraisers.

The county's liability of $365 million is also $40 million higher than the $325 million figure cited by the County Attorney and included in the Comprehensive Annual Financial Report of the Comptroller (CAFR) for the fiscal year ended December 31, 2002. The increase is primarily the result of the impact of the 2003 reassessment on residential properties.

Finally, we believe revisions to the methodology for future year estimates are necessary. ARC's December 31, 2003 real estate tax refund liability estimate was based on a statistically selected sample of all parcels, regardless of protest status. This sample was originally intended for a possible equalization ratio challenge by the Certiorari Bar. In future liability estimation processes, we recommend that ARC refer to actual settlements activity. Further, we recommend they stratify the overall liability by year.

Cc: Art Gianelli, Deputy County Executive
Elizabeth Botwin, Deputy County Attorney
Glenn Borin, Chairperson of the Assessment Review Commission
Nassau Interim Finance Authority

Appendix 2

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MEMORANDUM

Date: May 26, 2004

To: Richard L. Luke
Jeremy Wise

From: Glenn Borin

Subject: Real estate tax refund liability estimates

You have received a memorandum from the Comptroller’s office stating an estimate of the liability for real estate tax refunds based on future payments of claims pending on December 31, 2003. I offer the following comments in anticipation of your request:

We are pleased that the Comptroller’s office has generally accepted the methodology for estimating future liability proposed by OMB and ARC. We appreciate the effort made by that office to understand the issues and specify the components of their estimate of liability. Further, the review by the Comptroller’s Internal Audit Staff was helpful to us in identifying areas where continuing improvements can be made in the estimation procedures.

It important to note that the Comptroller’s estimate is made for balance sheet purposes and includes some $50 million in refunds that were due and payable on year end for cases already settled. In contrast, when projecting future payout beyond the current year, there is no need to include these already settled cases. Similarly, the liability for pending residential cases has no bearing on future payouts beyond the 18 month period in which such cases are resolved. We do not believe that this category was included in past estimates published by the Comptroller and observe that the spike in residential liability due to the impact of the revaluation has already begun to recede. With respect to the liability for unsettled commercial cases, while we agree that it is important to reduce the backlog, its size, at least within the range at issue, has a relatively minor impact on future payout relative to the impact of improved assessment quality through annual updates and final roll corrections by ARC.

Appendix 2

Finally, it remains our opinion that the commercial backlog from the pre-NIFA period has been reduced substantially and that the overall backlog, including the amount added by the 2003/04 revaluation roll, has been reduced moderately. In essence, the Comptroller has adopted all of our estimates except that for the liability added by the revaluation, where we differ by a factor of 50%, which is more than $40 million. This single component accounts for the difference between our estimate of commercial liability and the figure adopted by the Comptroller.

While we respect the expertise of the Comptroller's staff and the care with which they undertook this review, we respectfully disagree with their conclusion on this one issue. The other major components of our estimate, which are validated by the Comptroller's review, were obtained by using the same methods as were applied in obtaining the 2003/04 estimate. Logically, if one estimate is accurate, so is the other. Our method involved appraisals of a random sample. The results for the back years were consistent with the results from actual settlements negotiated in 2003, when more than 16,000 assessment challenges for the years 1993/94 through 2002/30 were settled and another 16,000 were discontinued.

For 2003/04, we used the same appraisals, made at the same time, by the same professional appraisal staff, with only typical adjustments for a one-year difference in the valuation date. In our opinion, there is no reason why the results would be inconsistent with those from the prior period. However, for the current year it was not possible to obtain confirmation by analysis of a large number of actual settlements. It had never been the practice in Nassau County to settle cases for the same year in which the roll was published. Although we have since made progress in obtaining acceptance of a more expeditious settlement process, during 2003 and early 2004 there virtually no settlements of 2003/04 assessments. The Comptroller's office used the results of fewer than 100 actual settlements. In our view, this group of cases was a highly biased, non random sample, in that the members of the tax review bar overcame their reluctance to settle current year cases when there were extreme errors in the assessment but not otherwise. As a result, the Comptroller's estimate for the 2003/04 commercial liability substantially overstates the rates of reduction that will be reflected in ARC and County Attorney settlements for that year.

C: Art Gianelli
Liz Botwin
Manuel Mosquera

Analysis of Real Estate Claims

		School 2003/2004 Town 2004				School 2004/2005 Town 2005					School 2005/2006 Town 2006			
		Residential Claims - Number of Parcels Grieved	Estimated Residential Refund Liability	Commercial Claims - Number of Parcels Grieved	Estimated Commercial Refund Liability	Residential Claims - Number of Parcels Grieved	Estimated Residential Refund Liability	Commercial Claims- Number of Parcels Grieved	Estimated Commercial Refund Liability		Residential Claims - Number of Parcels Grieved	Estimated Residential Refund Liability	Commercial Claims - Number of Parcels Grieved	Estimated Commercial Refund Liability
Claims filed 1/2/03 - 3/3/03 for 2003 and 2004	A													
Less: Reductions before 2003 Roll Closed through 4/1/03	B													
Less: Reductions made between Roll Closing and 4/1/04	C													
Add: Claims filed 1/2/04 - 3/1/04	D									D				
Less: Projected Reductions Settled between 4/1/04 and 3/14/05										E				
1 Open Claims	=A-B-C									F=D-E				

Appendix 4

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To: Howard Weitzman

From: Elizabeth Botwin

C: Art Gianelli, Deputy County Executive
Glenn Borin, Chair, Assessment Review Commission

Date: July 26, 2004

Re: Comments on Comptroller's Draft Financial Review of the Tax Certiorari Liability Calculation

Thank you for providing the opportunity to comment on your proposed audit of the Assessment Review Commission's estimate of tax certiorari liability. These comments are provided on behalf of ARC, OMB and the County Attorney's office.

The Comptroller's conclusion that the backlog liability is growing is obviously wrong; the Comptroller compared dissimilar figures to reach that conclusion. If the figures are compared "apples to apples," backlog liability has shrunk from $325 to $251.4 million.

The Comptroller determined that the backlog had increased by comparing the liability estimates prepared in the past by the County Attorney's Office to ARC's analysis of liability based on a sample of commercial property in Nassau County. The two figures are not comparable.

ARC prepared a statistically meaningful analysis of actual liability for the very first time in the County's history. Past year estimates were based on the County Attorney's educated guess. The methods are so different that the figures are not comparable.

The Comptroller created additional confusion by adding back into its estimate of backlog liability elements that were not considered in the liability estimate provided in 2003 or 2002.[1]

1. The Comptroller added $47.2 million to the backlog to reflect the liability for Small Claims Assessment Review ("SCAR") proceedings.[2] The County Attorney's Office in past years did not attempt to estimate the SCAR liability because those cases were not handled by the County Attorney and office staff would have no way of estimating the liability. In addition, because SCAR cases are resolved within 18 months of filing, they have never been considered a component of the certiorari backlog. The $47.2 million SCAR liability should be subtracted from total liability to be comparable to prior years' liability estimate.

2. The Comptroller added $8.1 million to the backlog to reflect possible Class 3 liability. The County Attorney's Office did not include any liability figure for Class 3 property since in general it generated no refunds. For similar reasons, ARC did not include Class 3 property in the sample, and only provided the $8.1 million estimate for Class 3 in an excess of caution outside of the sample analysis. The $8.1 million Class 3 liability should be subtracted from total liability to be comparable to prior years' liability estimate.

3. The Comptroller added $58.3 million to the liability estimate to reflect cases that had settled but had not yet been paid by December 31, 2003. The County Attorney's Office did not include liability for cases that had been settled. Once cases are settled they are merely an account payable and not appropriately part of a backlog estimate; the liability has been fixed and is no longer an undetermined future liability that needs to be estimated. Further, since settlement activity is accelerating, the accounts payable as refunds are substantially greater than the amounts would have been in the past (see tables one and two below). By adding back $58.3 million to reflect refund liability that had been determined but not yet paid as of December 31, 2003, the Comptroller added a new element to valuation of the backlog.

If the elements that had not been considered in 2003 as part of backlog valuation are subtracted, the backlog has shrunk to $251.4 million:

Comptroller estimate of 2003 refund liability	$365 million
Subtract SCAR liability	- 47.2
Subtract Class 3 liability	- 8.1
Subtract settled but not paid cases	- 58.3
	$251.4 million

[1] There are no records to show what elements the former Chief of the Tax Certiorari and Condemnation Bureau might have considered when he provided the unchanging estimate of $400 million in liability in all previous years.
[2] This figure was the SCAR liability estimate prepared by ARC, which the Comptroller accepted.

In addition, before reaching its conclusion that the value of the certiorari backlog had increased, the Comptroller had failed to consider statistical data showing that certiorari cases closed out in 2002 and 2003 substantially exceeded new filings in raw numbers:

Table One: Certiorari Cases Filed - Closed By Writ

	2000	2001	2002	2003
Cases Filed	12,068	11,901	12,132	12,327
Cases Resolved	6,930	11,331	15,990	16,310
Net Increase (Decrease) in Cases	5,138	570	(3,858)	(3,983)
Cases Resolved as % of cases filed	57%	95%	132%	132%

Similarly, statistical data shows that certiorari cases closed out in 2001, 2002 and 2003 substantially exceed new filings when considered in terms of assessed value:

Table Two: Certiorari Cases Filed - Closed by Assessed Value

	2000	2001	2002	2003*
AV of cases filed	1,300,127,219	1,248,941,778	1,210,996,256	1,216,792,395
AV of cases resolved	859,390,209	1,554,861,847	1,888,467,183	1,760,896,524
Resolved cases as percentage of filed cases by AV	66%	124%	156%	145%

*2003 assessed value converted to pre-revaluation level for consistent comparison

The Comptroller erred in adding new elements into the definition of the certiorari backlog and then concluding that the backlog had increased, especially since it reached that conclusion without consideration of the declining amount of open AV and declining number of open writs.

The Sampling of Liability was a Singular Achievement and a Total Break with the Past

The ARC liability estimate is not comparable to the estimates provided in all previous years. Before 2003, the County had never attempted a study of its outstanding tax certiorari liability. In previous years, the County Attorney’s Office had estimated liability based on a combination of the attorneys’ experience, conversations with the certiorari bar, and review of cases recently settled with those on upcoming calendars. The County Attorney’s Office was by far the most knowledgeable source of information on certiorari liability and their back of the envelope guesstimate was the best data available.[3] But their estimate was based on accumulated experience, not on any study of liability.

In the absence of an accurate count of liability, the Comptroller's Office simply accepted the County Attorney's number and included that figure in its financial statements without further analysis.

The County's outside auditors established a range of liability somewhere between $300 million and $700 million. This is such a wide range as to be not useful for planning purposes.

In 2003, OMB and ARC determined that it was important to prepare a real estimate of liability; one that was scientifically determined on the basis of an accurate sample of the properties with pending claims for refunds. The County could not prepare an accurate plan for payment of the backlog of tax certiorari cases without a more accurate determination of the extent of the liability. Similarly, the County needed an estimate of the liability that would be added by the new assessment rolls. Accordingly, ARC was assigned to develop the methodology to determine the extent of the backlog and the new liability added by the new assessment rolls.

Sal Guajardo, PhD. prepared a statistically valid random sample of the properties comprising the commercial and residential assessment roll. The Comptroller has not questioned the accuracy of the sample.

The sample included only the classes of property that consistently protest and receive refunds: Classes Two (apartment buildings and condominiums) and Four (all other commercial properties). County records show that no refunds are paid on Class Three (utility) properties as tax certiorari refunds;[4] therefore, those parcels were not sampled. Class One properties predominantly file Small Claims Assessment Review ("SCAR") proceedings, which are resolved within eighteen months and therefore do not fall into the backlog. Therefore, Class One properties were excluded from the sample.[5]

The appraisal professionals who work for ARC prepared appraisals of every property in the sample. The Comptroller's Office has not questioned the accuracy of the appraisals.

Once the property had been appraised, ARC determined the likely property tax refund liability, if any. The appraised value was compared to the value reflected by the assessment for each year, and the likely refund in a certiorari case was determined by subtracting the appraised value from the value reflected in

[3] The County did not even have an accurate record of the number of open cases. In 2001, NIFA approached the problem by requiring that the County Attorney assign staff to identify closed cases or cases that were abandoned by operation of time, obtain stipulations discontinuing the cases from the petitioners' attorneys, and then request that the Department of Assessment indicate in the Writ File in the Wang computer system that the writs were closed, in order to obtain a more accurate count of open cases. Although the County Attorney assigned two full time attorneys and one clerical assistant to this task throughout 2001 and 2002, the Writ File could not be scrubbed to any reliable level of accuracy. The County Attorney's Office abandoned the project as unachievable and reassigned its staff to handle litigated matters by late 2002.

[4] There has been large refund liability in two cases brought by the utilities, but these were not certiorari cases. This liability is reported as part of the general non-tax litigation liability, and is not subject to the special restrictions on borrowing and budgeting imposed by the NIFA Act on tax certiorari liability.

[5] Liability for the Class One properties that are excluded from the SCAR process was estimated based on SCAR trends.

each year's assessment, and multiplying by the tax rate in each year. The Comptroller's Office has not questioned this methodology, although staff questioned the way some of the tax rates and relevant interest components were calculated in the initial estimate of liability. The ARC estimate of liability was refined and revised, in part in response to these comments from the Comptroller's staff. The final ARC liability numbers reflect the changes made by ARC.

The Comptroller has accepted the final ARC liability analysis from the sample for every tax year from 1986 – 2002. Even though the properties in the sample and the appraisals of those properties are unquestioned for each tax year, for the 2003 year only, the Comptroller has rejected the analysis from the sample and made up his own methodology. The Comptroller's unscientific analysis of the 2003 liability is discussed below.

The Comptroller and ARC are actually in agreement on the estimate of liability for 1986 - 2002 and disagree only on the liability generated by the current assessment roll.

The Comptroller agreed with ARC's estimate of liability for all tax years between 1986 and 2002. For all those years, the liability found by the sample could be compared to the pool of approximately 16,000 settled cases. The actual results based on the settled cases show that the ARC certiorari liability estimate is overstated. Nevertheless, in an exercise of caution, we concur with the Comptroller's decision to accept the ARC estimate rather than adopt the projection based on settled cases for tax years 1986 – 2002.

The Comptroller's failure to acknowledge that it agrees with ARC's conclusion of liability for 16 tax years, and disagrees with only the 2003 tax year overstates the severity of disagreement between our offices.

The Comptroller's estimate of liability for the 2003 tax year is scientifically meaningless and obviously incorrect

For 2003 only, the pool of 16,000 settled cases does not exist. Only 70 cases had settled through the 2003 tax year by the time the Comptroller calculated its liability estimate (there were only 12 Class 2 settlements and 58 Class 4 settlements that included the 2003 tax year). These 70 cases were obviously unreflective of the pool of certiorari cases, since the property owners, or their representatives, broke with Nassau County custom and reached a settlement on the current tax year early on.[6] The Comptroller took these 70 cases, and assumed the total 2003 liability would be the same as that reflected by these cases.

There was no need to for the Comptroller to use these self selected 70 cases to make its 2003 tax year refund projection. It had the ARC statistically accurate sample of all properties in Nassau County. It had the accurate ARC appraisals of those properties, which it had used to determine refund liability for all other tax years 1986 - 2002. The accuracy of the sample and the property appraisals had not magically changed from 2002 to 2003 and the Comptroller provides no reason, let alone a logical rationale, to reject the ARC estimates for the 2003 tax year only.

[6] The County Attorney's office disagrees with Comptroller's characterization of the reason for this in the second bullet point on page 6 of the draft audit.

Moreover, even if the Comptroller properly rejected ARC's sample, its own sample was much worse. The Comptroller made no effort to determine whether the 70 cases were a statistically accurate sample of the over 12,000 writs filed for 2003. Indeed, since the 70 cases were self-selected they are obviously not an accurate sample of the whole. Further, the number of cases is obviously too small to use as a proxy for all 12,300 writs filed in 2003.

Finally, the conclusions drawn by the Comptroller on the basis of these 70 cases are so empirically unlikely that the Comptroller should have reconsidered its methodology. The Comptroller concluded that the 2003 tax year will generate refunds that far exceed the refunds paid during the real estate crash of the early 90's.

Over time, thousands of cases will settle through the 2003 tax year. The refunds based on those settlements will be at or under the ARC estimate, just as has proven the case in every other tax year. The administration respectfully requests that the Comptroller restate its finding of 2003 tax year liability in its 2003 CAFR and in future Financial Reports as its projection is proven wrong.

The audit discusses specific issues concerning ARC's initial liability estimate. After its first pass, ARC refined and corrected its methodology and revised its estimate accordingly.

The Comptroller criticizes ARC's first draft of the liability estimate, without acknowledging the subsequent refinements ARC made or that the Comptroller has adopted the liability estimate found by ARC on the basis of those refinements.

Allegedly Inadequate Documentation: Every item cited by the Comptroller as lacking in documentation is maintained by the County in its Wang mainframe system in the Department of Assessment's writ system. The data is not overwritten as changes are made. There was no reason for ARC to print out paper records of information that is retrievable from the computer. The Comptroller's insistence that ARC should have printed out and filed this information is irrational.

Calculation of historical tax rates: The refunds that were paid in past years are the best data for determining the tax rate to be used in projecting refunds from the sample. ARC's average tax rates were calculated by dividing AV by refunds paid and were compared to the actual tax rates for all localities in the years in question.

Class Three and Class One projections: ARC estimated liability for Class Three properties outside of the sample. Historically there has been no certiorari liability for these properties. ARC analogized from Class Four liability to project a possible refund of $8.1 million. The Class One properties that file certiorari writs, as opposed to SCAR petitions, represent too small a number to sample. Accordingly, ARC estimated the liability based on SCAR trends.

Interest Rates: The best way to calculate the appropriate interest rate is to use the actual data showing what the County has paid. ARC used the actual data.

Break out estimates by tax year: If ARC had the IT capability, it would have broken out the liability estimate by tax year as the Comptroller suggests. ARC still does not have an IT system that would permit such an analysis.

Appendix 5

Auditor's Follow-Up Response:

We appreciate the detailed response to the audit report provided by the Office of the County Attorney. The points raised in its response were brought to our attention and considered prior to the release of the report. The Comptroller's Office stands by its estimate of the Tax Certiorari Liability. Additionally, the methodology used and the liability balance reached by our office was reviewed and accepted by the County's Independent Certified Public Accountants, Deloitte and Touche.