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OFFICE OF THE STATE COMPTROLLER

November 23, 2004

Mr. Andrew S. Eristoff
Commissioner
Department of Taxation and Finance
State Office Campus-Building #9
Albany, NY 12227

Re: Report 2004-F-27

Dear Mr. Eristoff:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; and Article II, Section 8 of the State Finance Law, we have followed up on the actions taken by officials of the Department of Taxation and Finance (Department) to implement the recommendations contained in our audit report, *Administration of Selected Components of the Wage Reporting System* (Report 2001-S-42).

Background, Scope and Objectives

In July 1978, the New York State Tax Law (Law) required the New York State Department of Taxation and Finance (Department) to develop and operate a Wage Reporting System (System). The System contains the name, social security number, and gross wages paid to each employee that resides or is employed in the State. In 1998, the Unemployment Insurance Reform Act allowed the Department of Labor (DOL) the ability to access wages maintained on the Department's System. Beginning in 1999, the Department and DOL required employers to use a single form (known as the single file program) to provide wages and withholding information to DOL. As required by the Law, the Department requires each employer to file on a quarterly basis, a Quarterly Combined Withholding, Wage Reporting and Unemployment Insurance Return (quarterly return). When an employer does not file a quarterly return by the required due dates, the Law requires the Department to impose applicable penalties. The Department is also authorized to allow certain other State and Federal agencies (agencies) the ability to request employee wage information as reported by the employer to the Department while at the same time relying upon the Department's ability to maintain and protect the confidentiality of such data.

Chase Bank (Chase) was under contract (May 1998 through April 2003) to process quarterly returns for the Department. Employers submit quarterly returns either by magnetic media or in paper format. For quarterly returns submitted on paper, Chase data-enters or scans all employer and employee information on the quarterly returns and transmits all data to the Department on a magnetic tape within 25 days of receipt of the quarterly return. The Department then enters this data

on the System. Because Chase employees data-enter quarterly return information submitted on paper, the risk of not accurately recording quarterly return information is significantly higher than that of magnetic media. The Chase contract not only is with the Department, but it is with DOL because Chase directly transmits to DOL unemployment insurance information that is obtained from the same quarterly returns that provide employee and employer wage information to the Department for the System. DOL maintains the data that it receives from Chase on its own system.

Our initial audit report, which was issued on November 26, 2002, examined the Department's administration of selected components of the Wage Reporting System for the period January 1, 1999 through June 15, 2002. Our initial audit evaluated the accuracy of employee wage information and Social Security numbers submitted via paper and recorded on the Department's system and determined whether appropriate penalties were issued to non-compliant employers for failing to file a quarterly return by the required due date. It did not address how agencies utilize employee wage information requested from the System or how the accuracy of such information impacts on the programs of the user agencies. We concluded that the wages and/or social security numbers on the System are not always the same as the original employee wage and social security numbers as submitted in paper format by the employer. In addition, we found that the Department does not always issue appropriate penalties to employers who do not submit quarterly returns by the required due date. We further concluded that the Department needed to do more to ensure that Chase complies with the 95 percent accuracy standard for paper quarterly returns as required by the contract.

The objective of our follow-up, which was conducted in accordance with Generally Accepted Government Auditing Standards, was to assess the extent of implementation as of October 18, 2004 of the five recommendations included in our initial report.

Summary Conclusions and Status of Audit Recommendations

We found that Department officials have made significant progress in correcting some of the problems we identified in our initial audit report. Of the five prior audit recommendations, four recommendations have been implemented and one recommendation has not been implemented.

Follow-up Observations

Recommendation 1

Continue to work with Chase officials to ensure compliance with the 95 percent accuracy standard for paper quarterly returns as required by the contract.

Status - Implemented

Agency Action - The Department and DOL finalized a follow-up review on the paper processing accuracy soon after the initial audit. Based on their analysis, officials concluded that Chase exceeded the paper processing accuracy standard noted in the initial audit's recommendation. The Department provided Chase with their findings and indicated that they were in continuous communication with Chase regarding issues, errors and improvements. Department officials told us that the contract with Chase for wage reporting processing ended in September 2004. The Single File contract, including wage reporting, was awarded to Bank One. The Department is working closely with Bank One to ensure their employees are properly trained and that processes are in place to meet the 95 percent standard.

Recommendation 2

Ask Chase to increase and/or target training to its staff responsible for the data entry of paper filed quarterly returns and to conduct spot checks of the accuracy of the data entry of employee wage and social security information.

Status - Implemented

Agency Action - According to Department officials, Chase did improve their training program and added an additional quality control step to their process to include sampling work from their workflow. Further, Department officials indicated that Chase management evaluated the data entry process and dedicated one unit to conduct training to improve the overall process. However, the Wage Reporting contract has been awarded to Bank One as of September 2004. The Department is now working closely with Bank One to ensure their employees are properly trained.

Recommendation 3

If Chase continues to not meet the 95 percent accuracy standard for paper quarterly returns, pursue assessing penalties. In instances where the Department has decided not to assess a penalty, document the reason(s) why.

Status - Implemented

Agency Action - Based on their follow-up review of the paper process, officials concluded that Chase had met the contract standards. However, they will continue their efforts to improve the overall accuracy rate of the wage reporting data. Department officials indicated that the Department has and will use all appropriate measures to ensure contractors meet the contract standards. Since Bank One was selected as the new processor, the Department and DOL are planning a joint Wage Reporting audit in November of 2004.

Recommendation 4

Investigate large dollar employee wage discrepancies as identified in the wage discrepancy report

in a timely manner and make needed corrections on the System.

Status - Implemented

Agency Action - Officials state that they continue to review and correct errors identified on the Wage Reporting employee record database. Staff will continue to work on tax year 2002 accounts and additional staff has been assigned to work on tax year 2003. This process is accomplished through reports produced for the current top 1,000 candidates with the greatest differences. As discrepancies are cleared, the next 1,000 records appear on the report and staff work to clear the errors. This process is done for each reporting tax year and will continue until many of the errors are identified. Further, officials stated that there are several Wage Reporting processes that are used proactively as a measure to ensure data integrity. These processes included working with DOL and Chase to ensure that errors were handled in a timely manner. They were:

- Submission of requests for adjustments by DOL to the Department Mag Media/Wage Reporting (MM/WR) Unit was established. The MM/WR Unit reviews discrepancies identified on current quarter accounts, makes appropriate corrections and sends notification back to DOL in a timely manner. Since this process was first implemented, the Department has resolved over 1,300 cases.
- Working in conjunction with Chase, the MM/WR Unit sends paper listings of returns filed outside of the standard reporting format back to employers, along with a letter notifying them of the reason(s) for rejection. Since this process was first implemented, the Department has sent out over 8,500 rejection letters.
- Communication between the Department and Chase continues as errors are identified and resolved. Monthly conference calls are held to discuss processing and data capture issues and possible resolutions. Subsequent to resolution of the initial problems, these conference calls have been scheduled periodically, on an as needed basis.

Recommendation 5

Issue failure to file notices to employers that do not file a quarterly return by the prescribed due date.

Status - Not Implemented

Agency Action - Officials responded that although their programming work plan includes this proposal, the actual work is on hold pending a decision on legislation to transfer adjudication responsibility from the Department to DOL. Department officials stated that they are working with DOL for the passage of Senate bill S4228 (2003-2004 Regular Sessions), dated April 11, 2003, to amend the Law in relation to adjudication of penalties assessed for late filing of combined quarterly reports. The proposal would transfer adjudication responsibilities from the Department to the DOL.

Major contributors to this report were Arthur F. Smith and Alexander Marshall.

We would appreciate your response to this report within 30 days, indicating any actions planned to address the unresolved issues discussed in this report. We also thank the management and staff of the Department for the courtesies and cooperation extended to our auditors during this process.

Very truly yours,

Steven E. Sossei
Audit Director

cc: Robert Barnes, Division of the Budget
Andrew Maguire, Tax and Finance