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May 18, 1999

Mr. Arthur J. Roth
Acting Commissioner
Department of Taxation and Finance
Building #9
State Campus
Albany, New York 12227

Re: Report 98-F-55

Dear Mr. Roth:

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 reviewed the actions taken by officials of the Department of Taxation and Finance as of March 2, 1999 to implement the recommendations contained in our prior audit report, *Maintaining Employer Withholding Tax Accounts* (Report 96-S-43). Our prior report, which was issued July 10, 1997, examined the Department's practices for maintaining employer accounts in the Withholding Tax Program.

Background

Section 671 of the New York State Tax Law (Law) requires that every employer deduct and withhold income tax from employees' wages. In administering and enforcing the Law, the Department of Taxation and Finance (Department) maintains accounts for about 470,500 employers on its Withholding Tax System (WTS) and collects approximately \$19 billion in withholding tax receipts annually. WTS identifies employers who have underpaid or overpaid withholding taxes and calculates the respective assessments (notice of tax due) and refunds for these taxpayers. The Department must resolve employer protests of assessments, and must pay refunds due employers within 45 days or pay interest. The Office of the State Comptroller (OSC) must approve refunds before they can be paid.

Our prior audit addressed the practices related to employer account maintenance for the period July 1, 1993 through June 30, 1996.

Summary Conclusion

In our prior audit, we determined that generally the Department's WTS contained sufficient controls to ensure the proper maintenance of employer accounts. However, we found that the Department could take steps to reduce the number of adjustments that must be made to employer accounts and to ensure that protests are fully documented. We also found that the Department could improve the controls over refund processing.

In our follow-up review, we found that the Department had implemented our recommendations concerning non-posted exception credits, taxpayer protest resolution documentation, CARTS protest documentation and a timetable for the payment of withholding tax refunds. In addition, officials took some steps to address our concerns with the procedures to deactivate user ID's for separated employees and to improve the timeliness of refund processing. The Department had not implemented our recommendation to evaluate and to implement WTS changes to decrease the exception inventories. The Department also had not modified the automated abatement program to identify those potential assessments that may result in employer refunds.

Summary of Status of Prior Audit Recommendations

Our prior audit contained eight recommendations. We found that Department officials have implemented four recommendations, partially implemented two recommendations, and have not implemented two recommendations.

Follow-up Observations

Recommendation 1

Evaluate and implement the WTS system changes, as noted in this report, to decrease the exception inventories, including:

- (a) programing the system to re-balance accounts after receiving additional quarterly information;*
- (b) downloading exception inventory data; and*
- (c) updating the EFT indicator during the quarter.*

Status - Not Implemented

Agency Action - As of March 1999, the Department had not updated its WTS system to enable it to reconcile conflicting filing period dates. Although the Withholding Tax Bureau had requested the WTS changes from the Department's Information Systems Management (ISM) unit, other Departmental priorities, such as work on the Year 2000 problem, and work on the mandated merging of Unemployment Insurance (UI) and Withholding Tax information have taken priority over working on the WTS changes and updating the EFT indicator.

Recommendation 2

Modify the automated abatement program to identify those potential assessments that may result in employer refunds.

Status - Not Implemented

Agency Action - Department officials told us that they believed that this option was not cost effective from a programming perspective. Officials have implemented a manual processing procedure whereby all the low dollar balance due protests are reviewed to determine if a potential refund condition exists. Cases identified by this procedure are reviewed by supervisory staff for appropriate assignment and resolution.

Recommendation 3

Ensure the non-posted exception credits are not transferred inappropriately.

Status - Implemented

Agency Action - The Department established a discrete taxpayer account to enable them to segregate the information until the employer can be identified and payment resolved.

Recommendation 4

Revise written procedures to specify the time period in which the Department should deactivate user IDs for separated employees, and ensure that Department supervisors understand and follow these procedures.

Status - Partially Implemented

Agency Action - New procedures were adopted and transmitted to unit supervisors in January 1997. These include procedures for deactivating user ID's for separated employees. Officials told us that section heads and supervisors have met to reinforce the importance of deactivating user IDs in a timely manner. We found that three of the six employees who left the Withholding Tax Unit during the period December 1997 to December 1998

did not have their user IDs deactivated in a timely manner. One employee's ID remained active for six months after the employee left service.

Recommendation 5

Ensure that the resolution of each taxpayer's protest is adequately documented.

Status - Implemented

Agency Action - The Department now retains the Withholding Tax Protest Worksheet until the open assessment is closed. This document serves as an important link between the reason for the initial assessment and the basis for the final resolution. Once the assessment is closed the worksheet is retained for one year.

Recommendation 6

Ensure that all reasons leading to a protest's resolution are documented on CARTS.

Status - Implemented

Agency Action - Since our prior audit the Department has expanded and adjusted its reason codes to provide additional explanation for case resolution.

Recommendation 7

Continue to improve the timeliness of refund processing.

Status - Partially Implemented

Agency Action - Officials indicated that programming changes have been made to allow WTS to balance more returns each week. Programming changes have also been made to allow the Department to process more refunds per day. Department officials have also worked with the State Comptroller's pre-audit unit to establish a workable timetable for processing refunds to avoid having to pay interest on these refunds. However, our follow-up review showed that, although the average interest paid per (interest bearing) refund decreased from 1997 to 1998, the percentage of refunds on which interest was paid increased from 23 percent to 31 percent over this period.

Recommendation 8

Establish a workable timetable with the Comptroller's pre-audit unit for the timely payment of withholding tax refunds.

Status -Implemented

Agency Action - The Department proposed a schedule for the processing of withholding tax refunds to the State Comptroller's pre-audit refund unit. This schedule reduced processing time from 45 days to 15 days.

Major contributors to this report were William J. Nealon, Arthur F. Smith, Richard Loveless and Tom 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 would like to thank the management and staff of the Department for the courtesies and cooperation extended to our staff during this review.

Very truly yours,

Jerry Barber
Audit Director

cc: Mr. Charles Conaway