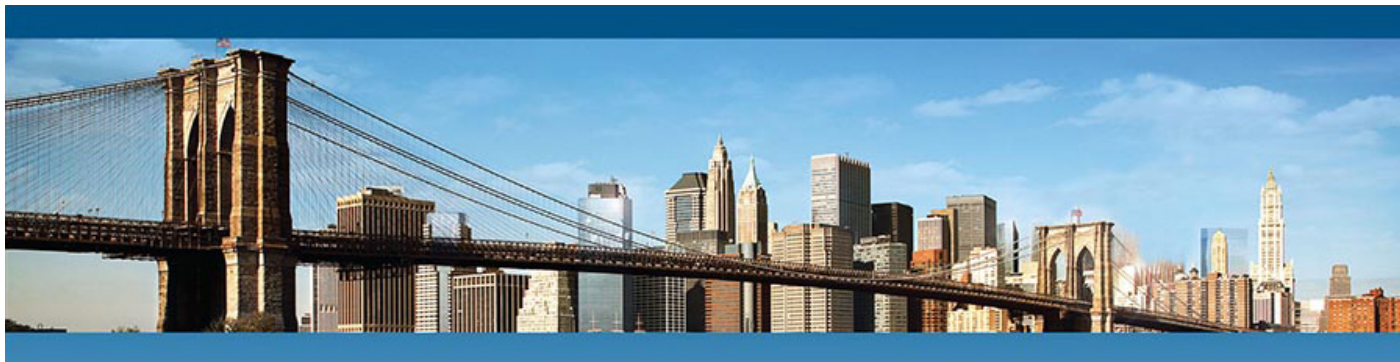




City of New York

OFFICE OF THE COMPTROLLER

Scott M. Stringer
COMPTROLLER



AUDITS AND SPECIAL REPORTS

IT AUDIT

Marjorie Landa

Deputy Comptroller for Audit

Audit Report on the
Reliability and Accuracy of General
Corporation Tax Data Administered by
the Department of Finance

7115-107A

June 29, 2016

<http://comptroller.nyc.gov>



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, NY 10007

SCOTT M. STRINGER
COMPTROLLER

June 29, 2016

To the Residents of the City of New York:

My office has audited the New York City Department of Finance (DOF) to determine whether the General Corporation Tax (GCT) data exists in a secure environment and is readily accessible only to authorized users, is sufficiently reliable for collection purposes, and contains required information for the enforcement and penalty collection process. We perform audits such as this as a means to ensure that systems and technological resources of City agencies are efficient, secure and operate in the best interest of the public.

The audit determined that during the audit scope period, GCT data generally existed in a secure environment with restricted access and was readily accessible only to authorized users identified by DOF. Specifically, the audit found that GCT data was generally reliable for collection purposes based on our examination of whether essential information, such as addresses, TIN numbers, and owner contact information for billing and collection purposes was missing from GCT. However, we also found that the agency's Fairtax system used to manage all tax revenue, billing and payment, did not track accounts with outstanding balances in real-time and that limit on functionality may have resulted in delayed collection of outstanding balances. We also found that tax bills only reflected the taxpayer's current year's GCT liability and did not automatically reflect cumulative GCT tax liability. Finally, we found several manual adjustments to GCT accounts in Fairtax that were not accompanied by reasons, descriptions, or proper approvals to justify their changes.

The audit makes six recommendations that, if implemented, should increase the efficiency of DOF's operations. Specifically, DOF should ensure Fairtax or any successor system has embedded modules to track GCT accounts in real-time, until paid or otherwise resolved. DOF should also reassess its process for reviewing and collecting outstanding balances owed to the City in order to expedite collection efforts and ensure Fairtax or any successor system has proper technical controls (i.e., mandatory fields) prior to accepting manual adjustments.

The results of the audit have been discussed with the DOF officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please email my Audit Bureau at audit@comptroller.nyc.gov.

Sincerely,

Scott M. Stringer

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THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER AUDITS AND SPECIAL REPORTS IT AUDIT

Audit Report on the Reliability and Accuracy of General Corporation Tax Data Administered by the Department of Finance

7115-107A

EXECUTIVE SUMMARY

We audited the Department of Finance (DOF) to determine whether the General Corporation Tax (GCT) data exists in a secure environment and is readily accessible only to authorized users, is sufficiently reliable for collection purposes, and contains required information for the enforcement and penalty collection process. DOF has a broad range of responsibilities that includes collecting nearly \$35 billion annually in revenue for the City of New York (City) and administering the City's business and excise taxes. Among its many responsibilities, DOF administers the City's GCT, which accounted for \$2.9 billion in revenue in Fiscal Year 2015.

The GCT process starts when a business taxpayer files an annual return, which can be done either by paper or electronically. All paper tax forms are scanned and validated by a third party vendor, and check payments are mailed to a bank lockbox. All electronic filings are transmitted to DOF daily from a vendor-managed electronic collection point. During the audit scope period, the tax information was sent to DOF electronically daily and uploaded into the agency's Fairtax system (Fairtax). Fairtax maintained GCT transactions and generated notices when taxpayers failed to pay taxes on time. When there is a failure to pay taxes on time, Fairtax issued a Notice of Tax Due with interest and penalties accrued.

If a taxpayer has not paid after 30 days of such a notice being issued, the taxpayer will be issued a Notice and Demand for Payment. Upon the issuance of the Notice and Demand for Payment, the case is transferred to DOF's Collections Division. However, if a taxpayer has been audited, Fairtax would send a Notice of Tax Determination. If the taxpayer still has not responded 90 days after the issuance of the Notice of Tax Determination, a Notice and Demand is sent as a final reminder. Upon the issuance of the Notice and Demand for Payment, the case is transferred to DOF's Collections Division.

Fairtax administration of the GCT was replaced by the Business Tax System (BTS) in January 2016. According to DOF officials, BTS is slated for full implementation by the close of 2017, when it will replace Fairtax completely. However, the GCT was managed through Fairtax during the entire audit scope period.

Audit Findings and Conclusions

We found that GCT data generally existed in a secure environment with restricted access, and is readily accessible only to authorized users identified by DOF. Security policies and technical controls restrict unauthorized access and provide a safeguard to GCT data. We also found that GCT data was generally reliable for collection purposes based on our examination of whether essential information for billing and collection purposes was missing from GCT. We further determined that the data provided the necessary information for enforcement and penalty collection and included addresses, TIN numbers and owner contact information. In addition, we found that Fairtax made automatic corrections to accounts for taxpayers who selected an inappropriate option on their returns.

However, based on the GCT data we received from DOF, we found a total of \$195 million in outstanding GCT balances owed to the City. This amount does not reflect accounts with pending decisions, nor transactions that are processed in batch that may decrease the outstanding balances owed when processed. Several weaknesses we identified in DOF's tracking and collection processes may have contributed to the creation of outstanding arrears. Among other things, we found that, on average, DOF forwarded 14 percent of the accounts in arrears to its Collections Unit each year. We also found that Fairtax did not track accounts with outstanding balances in real-time, which may have resulted in delays in the collection of outstanding balances. In addition, we found that tax bills only reflected the taxpayer's GCT liability for the current year and did not automatically reflect cumulative GCT tax liability. Our analysis found several cases where taxpayers had outstanding balances for two or more consecutive years. Finally, we found several manual adjustments to tax return accounts in Fairtax that were not accompanied by reasons, descriptions, or proper approvals to justify their changes. The failure of the system to require a reason for a change and/or a mandatory electronic approval process could enable unauthorized adjustments and make it more difficult for management to monitor these adjustments.

Audit Recommendations

DOF should:

- Ensure Fairtax or any successor system has embedded modules to track GCT accounts in real-time, until paid or otherwise resolved.
- Reassess its process for reviewing and collecting outstanding balances owed to the City in order to expedite collection efforts, and to make GCT data in Fairtax or any successor system more reliable.
- Ensure Fairtax or any successor system has the capability to display a taxpayer's cumulative balances in real time and to automatically transmit invoices that reflect cumulative balances.
- Review all accounts with missing RSN, RSN descriptions, and/or approvals to ensure that they were appropriately adjusted.
- Ensure Fairtax or any successor system has proper technical controls (i.e., mandatory fields) prior to accepting manual adjustments.

- Ensure that all manual adjustments include a RSN, RSN description, and proper approvals in Fairtax or any successor system.

Agency Response

DOF agreed with three of the audit recommendations, partially agreed with two and disagreed with one. While DOF agreed with certain systemic findings and recommendations, DOF disagreed with the audit finding and recommendation that related to outstanding balances that may result in loss of revenue.

The full text of DOF's response is included as an addendum to this report.

AUDIT REPORT

Background

DOF has a broad range of responsibilities that include collecting nearly \$35 billion annually in revenue for the City and administering the City's business and excise taxes. Among its many responsibilities, DOF administers the GCT, a tax the City imposes on domestic and foreign corporations that engage in business activities in the City, including employing capital, owning or leasing property, or maintaining an office.¹ The City's GCT revenue accounted for \$2.9 billion in Fiscal Year 2015.

The GCT process starts when a business taxpayer files an annual return. Generally, annual return filing and tax payments for GCT must be postmarked by March 15th of the following tax year. A taxpayer is responsible for self-assessing income, filing, and paying taxes on time. GCT payments can be either prepaid or paid in installments. DOF allows three extensions for filing within one year for filing tax returns. Payment must be made even where an extension for filing is requested.

GCT returns can be filed either by paper or electronically. All paper tax forms are scanned and validated by a third party vendor, and check payments are mailed to a bank lockbox.² All electronic filings are transmitted to DOF daily from a vendor-managed electronic collection point. All tax information is sent daily to DOF electronically and, during the audit scope period, was uploaded into the agency's Fairtax system, which managed all tax revenue, billing and payment for DOF.

During the audit scope period, Fairtax maintained GCT transactions and generated notices when taxpayers failed to pay taxes on time. When there was a failure to pay taxes on time, Fairtax issued a Notice of Tax Due with interest and penalties accrued. If a taxpayer did not pay after 30 days, the taxpayer was issued a Notice and Demand for Payment. Upon the issuance of the Notice and Demand for Payment, the case was transferred to DOF's Collections Division.

If a taxpayer had been audited, Fairtax would send a Notice of Tax Determination. If the taxpayer still had not responded after 90 days of the issuance of the Notice of Tax Determination, Fairtax sent a Notice and Demand as a final reminder. Upon the issuance of the Notice and Demand for Payment, the case was transferred to DOF's Collections Division.

Fairtax administration of the GCT was superseded at the start of Calendar 2016 by a new system. To improve the billing, payment, and collection process, DOF entered into a \$22.82 million contract (covering the period January 2015 to January 2020) with Fast Enterprises, LLC, to develop BTS. According to DOF officials, it is slated to be fully implemented by the close of 2017, when it will replace Fairtax with regard to all taxes. The first phase of BTS, which included GCT, came online in January 2016. However, the GCT was managed through Fairtax during the entire audit scope period.

¹ Effective for tax years beginning January 1, 2015, the GCT only applies to corporations that are S corporations for federal income tax purposes under Part D of Chapter 60 of the New York State Laws of 2015.

² SourceCorp is responsible for scanning and validating the tax form information to improve data-entry accuracy. SourceCorp performs transaction balancing, field validations, and digital validations. Once the tax form information has been validated, SourceCorp will forward the information to DOF. Meanwhile, Wells Fargo Bank processes and validates the payments made by check.

Objectives

The objectives of this audit were to determine whether the GCT data:

1. Exists in a secure environment and is readily accessible only to authorized users;
2. Is sufficiently reliable for collection purposes; and
3. Contains required information for the enforcement and penalty collection process.

Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and 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. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit was from January 2009 to December 2013. This audit was suspended from April, 2013, to October, 2014, pending the conclusion of a legal process concerning access to GCT data. We conducted fieldwork from October 2014 to March 2016. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

Discussion of Audit Results

The matters covered in this report were discussed with DOF officials during and at the conclusion of this audit. A preliminary draft report was provided to DOF officials and was discussed at an exit conference held on May 19, 2016. The discussions with DOF were considered in preparation of the draft report. On May 27, 2016, we submitted a draft report to DOF with a request for written comments. DOF submitted a written response to our draft report on June 14, 2016.

In its response, DOF agreed with three of the audit recommendations, partially agreed with two and disagreed with one. By way of agreement, DOF stated, among other things, that it “generally is interested in reducing its reliance on batch processing to increase the efficiency of its computer systems.” However, DOF also stated “[t]he draft audit . . . does not take into account DOF’s new Business Tax System (BTS), which replaced Fairtax for corporate tax operational purposes in January 2016.” In addition, DOF disagreed with the audit finding and recommendation relating to “outstanding balances may result in loss of revenue.” DOF officials stated:

These findings reflect a lack of understanding of DOF’s audit process, especially how audit assessments are finalized prior to being referred for collection action, and DOF’s collection efforts. In fact, a DOF review of the larger cases included in the \$195 million found that more than \$125 million was not outstanding collectible debt.

DOF used Fairtax financial computer system to manage all tax revenue, billing, notice, and payments. We understand that although some balances in certain statuses (i.e. pending

bankruptcy, pending administrative or judicial appeal) may not be “collectable debt,” they are still reflected in Fairtax as outstanding balances until paid, adjusted, or otherwise adjudicated in favor of the taxpayer. It is indeed the varied statuses of the taxes assessed from year to year, and the different systems in which information about each year’s assessment are maintained, that underlie our recommendation that DOF carefully reassess its process for reviewing and collecting outstanding balances owed to the City, taking into consideration its procedures and the system weaknesses identified in our audit.

With regard to DOF’s new BTS, while the first phase of that system came online in January 2016, the GCT was managed through Fairtax during the entire audit scope period, January 2009 through December 2013.

The full text of DOF’s response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

We found that GCT data generally existed in a secure environment with restricted access, and was readily accessible only to authorized users identified by DOF. Security policies and technical controls restricted unauthorized access and provided a safeguard to GCT data. We also found that GCT data was generally reliable for collection purposes based on our examination of whether essential information for billing and collection purposes was missing from GCT. We further determined that the data provided the necessary information for enforcement and penalty collection and included addresses, TIN numbers and owner contact information. In addition, we found that Fairtax made automatic corrections to accounts for taxpayers who selected an inappropriate option on their returns.

However, the GCT data we received from DOF reflected a total of \$195 million in outstanding GCT balances owed to the City.³ This amount does not reflect accounts with pending decisions, nor transactions that are processed in batch that may have yet to be updated. Several weaknesses we identified in DOF's tracking and collection processes may have contributed to the creation of these large arrearages. Among other things, we found that, on average, DOF forwarded only 14 percent of the accounts in arrears to its Collections Unit each year. We also found that Fairtax did not track accounts with outstanding balances in real-time, which may have resulted in delayed collection of outstanding balances. In addition, we found that tax bills only reflected the taxpayer's current year's GCT liability and did not automatically reflect cumulative GCT tax liability. Our analysis found a number of cases where taxpayers had outstanding balances for two or more consecutive years. Finally, we found several manual adjustments to tax return accounts in Fairtax that were not accompanied by any explanation or approvals to justify the changes. The failure of the system to require a reason for a change and/or a mandatory electronic approval process could enable unauthorized adjustments and make it more difficult for management to monitor those adjustments.

Outstanding Balances May Result in Loss of Revenue

DOF has procedures in place to review and collect GCT balances where the taxpayers are in arrears. These include, but are not limited to, a Collections Unit that is responsible for collecting outstanding balances. In order to conduct queries to verify the reliability of the data reported for collection as of January 2015, we received GCT data that contained payment transactions for the tax period January 2009 through December 2013. The data we reviewed reflected approximately \$270 million in outstanding balances.

In addition to the work of the Collections Unit, GCT accounts with outstanding balances are reviewed and investigated by various DOF personnel and divisions, including DOF's Quality Analysis Group and its Audit Division. To track and support case management, DOF has used a combination of Fairtax, Professional Auditing Support System (PASS), and Revenue Information Database (RID). PASS and RID had the capability to pull data from Fairtax. However, while taxpayers' accounts may have been updated in PASS and RID when they were worked on by the Quality Analysis Group or the Audit Division in those systems, the updates would not be reflected in Fairtax in real-time. Thus, Fairtax could not be used as an effective tool for collecting

³ This amount may have been overstated to the extent that the accounts that reflect the taxes due may not have been updated in Fairtax. DOF divisions such as Audit and Collections were able to utilize Fairtax data and make manual adjustments to it. However, these actions may be taken outside of Fairtax and would not affect the balances of taxes due in Fairtax. Since these are not automatically reflected in Fairtax, we do not have assurance that the balances of GCT taxes due on any given date are accurate.

outstanding balances since the status of the accounts may not have been up to date. DOF did not have embedded modules in Fairtax to allow GCT accounts to be tracked in real time.

DOF Response: “Our review of the Comptroller’s worksheets indicates that the audit focused almost exclusively on adjustments made within the financial transaction portion of our Fairtax computer system without taking into account rules and procedures for finalizing audits after adjustments are entered. The draft audit report also does not take into account DOF’s new Business Tax System (BTS), which replaced Fairtax for corporate tax operational purposes in January 2016.”

Auditor Comment: DOF misses the point when it complains that our audit “almost exclusively” focused on adjustments made within the financial transaction portion of Fairtax. The focus of this audit was on the security and reliability of the GCT data maintained by DOF and was based on the GCT data DOF provided that contained five-year payment transactions from January 1, 2009, to December 31, 2013. As noted by DOF, BTS was not in existence during that period or even by January 2015, the date as of which we tested DOF’s systems to verify the reliability of the data it reported for collection. The data we tested contained outstanding balances that had existed for as long as six years. Our review of “adjustments” to these outstanding balances revealed areas of concern due to a lack of technical controls in Fairtax. When we asked DOF for clarification of those balances, DOF reviewed and adjusted the top 20 accounts from \$270 to \$195 million using multiple data sources. It is only now, in its response to this audit, that DOF mentioned further adjustments in 2016 to these balances.

We compared GCT accounts with outstanding balances to the accounts in DOF’s Collections Unit and found that, on average, only 14 percent of the outstanding GCT accounts were forwarded to the Collections Unit per year. DOF stated that ongoing audits of corporations, payment extensions, corporate bankruptcies, and the lack of resources were factors that contributed to the delay and low referral rates we observed in its forwarding outstanding cases to the Collections Unit. DOF also stated that it focuses its collection efforts on accounts with larger balances that are owed to the City.⁴

DOF Response: “The Comptroller’s Office methodology severely distorts the referral rate of open liabilities to the Collections Division. Not only does the draft audit report erroneously include as open liabilities adjustments that were not yet finalized or were contested by taxpayers, it also ignores cases that were referred to the Collections Division and successfully resolved through payment or adjustment. The case balances of these cases were zero as of the time the Comptroller’s Office selected its sample.”

Auditor Comment: We disagree with DOF’s claim that the inclusion of open liabilities that were not yet finalized distort the referral rate of open liabilities. We do not purport to show the referral rate of fully collectable liabilities, but rather, as stated, the 14 percent reflects the referral rate of open liabilities. We fully understand that current and previous years’ account balances may be currently uncollectable due to many factors, including extensions, litigation, and bankruptcies. However, it is undisputed that these account balances remain outstanding and DOF tracks their status in

⁴ While DOF did not specifically define what it considered to be “larger balances,” when it researched GCT accounts with outstanding balances, the agency reviewed the top 20 accounts with outstanding balances, which were between \$148,000 and \$11,000,000.

multiple databases that did not communicate with Fairtax in real time. Until those statuses changed and the amounts due were finalized and paid, DOF continued to show them as outstanding balances due. DOF did not provide evidence regarding whether the accounts with outstanding balances were uncollectable due to extensions, litigation, bankruptcies, or for some other reason. Without a system that operates in real-time, DOF has to research each case to determine the collectability of the individual account balances. Based on the information submitted to us by DOF, only 14 percent of the outstanding accounts were referred to its Collections Unit on average. We note that DOF cited, among other reasons, its lack of resources as a contributing factor to why the agency could not review all outstanding accounts and so focused collections efforts on the accounts with the largest balances.

In addition, GCT account balances as maintained in Fairtax were not cumulative, but rather, were kept independently for each year. Therefore, outstanding account balances from previous billing periods were not reflected in the statement of taxes due for the next billing period. Our tests found a number of instances where taxpayers had outstanding balances for two or more consecutive years. For example, a taxpayer who did not pay GCT in 2011 and 2012 sent a payment for 2013; the previous years' balances, \$23,636 and \$63,087 respectively, remained outstanding. DOF's practice of not sending an automatic cumulative balance invoice to taxpayers though Fairtax would likely reduce the effectiveness of collection efforts and result in loss of revenue.

We forwarded the \$270 million in outstanding account balances we found to DOF officials for further clarification. They reviewed the accounts and provided additional information in November 2015, such as amendments to existing tax returns and recent payments for the 20 accounts with the largest outstanding balances, which reduced the amount of the outstanding balances reflected in Fairtax to more than \$195 million (see Table I below).⁵

Table I
GCT Outstanding Balances⁶

Year	Original Outstanding Balance As of September 2015	Total Accounts with Outstanding Balances As of November 2015⁷	Revised Outstanding Balance As of November 2015
2009	\$43,128,874	50,152	\$40,506,407
2010	\$124,696,740	50,615	\$55,244,166
2011	\$29,168,766	50,510	\$29,805,425
2012	\$28,929,473	52,687	\$29,082,269
2013	\$43,616,694	52,493	\$40,611,079
Total	\$269,540,547		\$195,249,345

⁵ DOF did not provide any additional information for the remaining accounts, stating time constraints in researching over 50,000 GCT accounts with outstanding balances.

⁶ The table reflects a cumulative balance of all accounts with an outstanding balance greater than \$0.00. DOF does not have a minimum write off balance for GCT.

⁷ It should be noted that some accounts have outstanding balance in multiple years.

Recommendations

DOF should:

1. Ensure Fairtax or any successor system has embedded modules to track GCT accounts in real-time, until paid or otherwise resolved.

DOF Response: “DOF partially agrees. . . . [T]here is no collection benefit to having a system that makes adjustments in real time compared to an overnight batch process. In many instances, a taxpayer may exercise its rights to contest tax adjustments even after a statutory notice is issued. DOF generally is interested in reducing its reliance on batch processing to increase the efficiency of its computer systems.”

Auditor Comment: While taxpayers’ accounts may have been updated in other systems or by other divisions, that information was not reflected in Fairtax. DOF needed to take further steps prior to adjusting outstanding account balances. Again, Fairtax, which managed all tax revenue, notice, billing, and payment for DOF during the audit scope period, calculated tax due for GCT. It would be beneficial and a useful management tool for accounts to be updated in real-time to reflect current tax due at any given time. A consolidated system, which incorporates the features and functions of RID and PASS, coupled with the ability to perform real-time adjustments, should be considered. This type of system would increase the accuracy of account balances, and would provide a great collection benefit to the City.

2. Reassess its process for reviewing and collecting outstanding balances owed to the City in order to expedite collection efforts, and to make GCT data in Fairtax or any successor system more reliable.

DOF Response: “DOF strongly disagrees with the Comptroller’s Office assumption that as soon as adjustment are entered into a computer system, the amounts constitute outstanding balances owed to the City. . . . DOF is working to fully leverage the functions of BTS to enhance its collections of adjustments that are properly referred to Collections.”

Auditor Comment: DOF incorrectly states that the Comptroller’s Office assumes that adjustments, when entered, are immediately collectable. We understand that that is not the case. However, we note that the outstanding account balances addressed in the report were from tax period 2009 to 2013. DOF made adjustments to accounts in Fairtax after we reported the outstanding balances of \$270 million in October 2015. In addition, in DOF’s response, it reports that it has made further adjustments to these accounts in May, 2016. Some of these balances have been outstanding for as long as six years. We are pleased to hear that DOF is working to leverage the functions of BTS to enhance their collection efforts. However, DOF should still reassess its process for review and collection of outstanding balances.

3. Ensure Fairtax or any successor system has the capability to display a taxpayer’s cumulative balances in real time and to automatically transmit invoices that reflect cumulative balances.

DOF Response: DOF partially agrees with this recommendation. “DOF does agree that there is a need to display cumulative balances on its computer systems for collection purposes, but only for tax assessments that have been statutorily fixed.

Lack of Controls May Lead to Unauthorized Adjustments

Account balances may need adjustment due to filing errors, prepayment discrepancies, actual overpayments, credit offsets, or refunds requested by taxpayers. In certain instances, adjustments must be made manually after review and processing through various DOF units. Fairtax will make most adjustments automatically. The automated processes use predetermined formulas such as verifying math computations or adjusting overpayments.

However, during our analysis of the GCT data, we found that Fairtax did not have controls to ensure that manual adjustments made to GCT accounts in Fairtax contained adequate justification and evidence of required authorizations. We requested a data file of all adjustments to accounts during our scope period of 2009 to 2013; there were more than 900,000 such adjustments. Based on our tests of these 900,000-plus adjustments, we found that 5,582 were manually adjusted. We noted that DOF’s procedures for offset requires a reason code (RSN), RSN description, and approvals to ensure all account changes are authorized. However, we found that of the 5,582 manual adjustments, 729 (13 percent) did not include a RSN, or a RSN description, or proper approval. We randomly selected from the 729 a sample of 100 for detailed review in Fairtax and verified that 66 out of 100 did not have RSNs or proper approvals. These 66 adjustments resulted in a total tax collection reduction of \$378,503. The remaining 34 adjustments contained the appropriate RSNs and approvals.

We note that DOF limited Fairtax access to only authorized users and maintains an audit trail to monitor unauthorized transactions. Thus it would be possible for DOF to track user activity in the event of unapproved transactions.

Recommendations

DOF should:

4. Review all accounts with missing RSN, RSN descriptions, and/or approvals to ensure that they were appropriately adjusted.

DOF Response: “DOF agrees with this recommendation. We are working to ensure that all adjustments entered into BTS have an appropriate reason code”

5. Ensure Fairtax or any successor system has proper technical controls (i.e., mandatory fields) prior to accepting manual adjustments.

DOF Response: “DOF agrees with this recommendation. We are reviewing BTS to ensure that all manual adjustments have proper technical controls”

6. Ensure that all manual adjustments include a RSN, RSN description, and proper approvals in Fairtax or any successor system.

DOF Response: “DOF agrees with this recommendation.”

DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and 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. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit was from January 2009 to December 2013. This audit was suspended from April, 2013, to October, 2014, pending the conclusion of a legal process concerning access to GCT data. We conducted fieldwork from October 2014 to March 2016. To achieve our audit objectives, we:

- Interviewed various DOF officials from the Payment Operations unit, Data Intelligence Group, Quality Analysis Group, Audit Unit, Collections Unit, and the Finance Information Technology Unit to better understand their performance tasks and operations for collecting GCT;
- Reviewed organizational charts and conducted process walk-throughs with DOF officials to understand DOF administration and responsibilities for collecting GCT;
- Reviewed GCT business rules, tax forms, and filing instructions to determine its consistency with NYC Administrative Code §11-602-610; and
- Reviewed and analyzed GCT tax forms NYC- 4S, NYC 4S EZ, NYC 3A and NYC 3L to determine if their instructions and procedures adequately applied the necessary fields and information for calculating GCT on the forms.

To achieve our audit objectives in determining whether GCT data exists in a secure environment and is readily accessible only to authorized users, we:

- Reviewed and analyzed DOF *Security Guidelines and Policy* and *Standard Operating Procedures Mainframe Security Policy* to determine whether DOF policy and procedures provide adequate technical controls to ensure proper system operations, data integrity and data security in Fairtax;
- Determined whether DOF user access controls complied with Department of Information Technology and Telecommunications (DoITT) *Identity Management Security Policy* and DoITT's *Citywide Information Security Password Policy*; and
- Requested a complete list of essential personnel who were granted access to GCT to determine whether their access privileges were appropriate, and whether GCT data is readily accessible to all essential personnel. As an audit criteria, we used DoITT's *Identity Management Security Policy* to compare the list of GCT user accounts to New York City Payroll Management System to ensure that all were still active employees.

We received GCT data that contained five-year payment transactions from January 1, 2009, to December 31, 2013. To verify the reliability of the data reported for collection, we:

- Performed several frequency distributions tests to determine whether any fields designated as mandatory were left blank or contained duplicate data;
- Performed queries to ascertain whether critical data elements needed for billing and collection purposes were missing, including EIN, account ID, owner's name, business address, and total tax due;
- Performed queries to examine records for invalid or inappropriate dates or data;
- Conducted system walkthroughs to review DOF's procedures for validating taxpayer information;
- Performed queries to ascertain whether Fairtax made corrections to taxpayers who selected an inappropriate tax option on their returns;
- Ran queries for all outstanding balances for GCT accounts to determine whether DOF had the appropriate information to take action to ensure that outstanding balances were paid;
- Reviewed GCT accounts in the Collections Unit with the GCT outstanding accounts from the data file to determine how many outstanding accounts were in the Collections Unit;
- Examined cases in the Bankruptcy unit to determine DOF process for collecting and closing out Bankrupt accounts;
- Reviewed and analyzed GCT daily process for transferring data from the vendor to Fairtax to determine whether the process was reliable and complete;
- Requested that DOF review and verify the outstanding GCT balances in Fairtax in October 2015; and
- Received a txt file with GCT adjusted accounts from tax period 2009 to 2013 to determine whether the adjustments adhered to DOF policies and procedures. DOF performed a total of 923,180 account adjustments over the five-year tax period. Of these adjustments, 5,582 were made by manual review and processed through various DOF units. We reviewed the txt file to determine whether adjustments made by automated process through Fairtax and any manual adjustments included all required justifications. We randomly selected 100 manual adjustments (of the 729 that were missing the adjustment reason codes) to examine whether Fairtax has proper system controls.



City of New York
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June 14, 2016

Ms. Marjorie Landa
Deputy Comptroller for Audit
Office of the City Comptroller
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New York, NY 10007

Re: Draft Audit Report on the Reliability and Accuracy of General Corporation Tax Data Administered by the Department of Finance (7I15-107A)

Dear Deputy Comptroller Landa:

The Department of Finance (DOF) has reviewed the draft *"Audit Report on the Reliability and Accuracy of General Corporation Tax Data Administered by the Department of Finance (7I15-107A)"* dated May 27, 2016 by the New York City Comptroller's Office (the Comptroller). DOF appreciates the Comptroller's positive findings that GCT data generally existed in a secure environment, is readily accessible only to authorized users, is sufficiently reliable for collection purposes and provided the necessary information for enforcement and penalty collection. However, DOF disagrees with several other findings and conclusions that demonstrate a misunderstanding of our audit process and collection efforts.

Introduction

DOF administers revenue compliance programs to recoup business and excise taxes that are not voluntarily reported and paid by taxpayers. Through the use of tax audits, enforcement actions and collection efforts, DOF has thus far collected more than \$1 billion in New York City tax revenue for the current fiscal year (FY2016), three months before the end of the reporting period, which runs from September 1, 2015 through August 31, 2016 for accounting reasons. This

marks the third time over the past four fiscal years that DOF has brought in more than \$1 billion. This audit focuses on the administration of general corporation tax from tax year 2009 through tax year 2013. During the roughly equivalent period of FY2009 through FY2013, DOF's audit, enforcement and collection programs brought in an additional \$2.6 billion in general corporation taxes. DOF has a sophisticated program that scores all filed corporation tax returns for their potential in producing audit assessments, and it conducts roughly 1,600 tax audits a year to realize this revenue. DOF's Collection Division files judgments against all entities with liabilities exceeding \$25 after this action is statutorily authorized.

"Outstanding balances – loss of revenue"

DOF strongly disagrees with the Comptroller's Office claims that it found \$195 million in outstanding GCT liabilities as of November 2015 that reflects a weakness in DOF's tracking and collection process. These findings reflect a lack of understanding of DOF's audit process, especially how audit assessments are finalized prior to being referred for collection action, and DOF's collection efforts. In fact, a DOF review of the larger cases included in the \$195 million found that more than \$125 million was not outstanding collectible tax debt. A significant portion of the remaining amount likely had a similar status.

Our review of the Comptroller's worksheets indicates that the audit focused almost exclusively on adjustments made within the financial transaction portion of our Fairtax computer system without taking into account rules and procedures for finalizing audits after adjustments are entered. The draft audit report also does not take into account DOF's new Business Tax System (BTS), which replaced Fairtax for corporate tax operational purposes in January 2016.

An integral part of fairness in the audit process is ensuring that a DOF assessment for additional tax is accurate before being made final and respecting the taxpayer's legal right to contest audit results once they are final. The audit report makes the incorrect assumption that DOF should be actively seeking collection from taxpayers the moment an audit adjustment is entered into Fairtax. In the exit conference, we described several circumstances that prohibit or restrict our legal ability to collect -- pending bankruptcy, pending administrative or judicial appeal, out-of-business status, and other miscellaneous reasons.

The following pertains to the \$195 million cited by the City Comptroller as outstanding.

In the case of federal and New York State audit changes that may affect a corporation's New York City liability for applicable tax years, DOF issues a preliminary assessment using the best available information but then conducts a more detailed review of the taxpayer's books and records so that we can issue a more accurate assessment. In fact, one case, involving seven related taxpayers with preliminary federal and/or state audit changes, accounted for more than \$70 million of the \$195 million referenced by the Comptroller's Office and after careful review those assessments were cancelled in November 2015. Similarly, another corporation reported federal and/or State audit changes to us that initially created a preliminary tax assessment of \$8.8 million, but DOF's review revealed that the reporting form omitted legitimate New York City credits. The adjustment was cancelled in May, 2016 in our BTS system. We also identified an

adjustment made to a corporation whose audit is still in progress. The adjustment of \$1 million cited by the Comptroller's Office was rescinded in January, 2016 in our BTS system.

While DOF actively works with taxpayers to obtain their consent to audit findings (in FY15, for example, 76 percent of completed audits were consented to by taxpayers), DOF may not seek to collect prior to sending the taxpayer a statutory notice of determination and providing the taxpayer the opportunity to challenge DOF's assessment. The law allows the taxpayer up to 90 days to decide whether it wishes to consent to the audit findings or to formally contest the findings. The taxpayer may decide to consent to the audit findings during this 90 day period and submit payment to DOF, but DOF may not demand payment. If the taxpayer chooses to formally contest the audit findings by requesting a conciliation conference or a hearing, DOF may not demand payment until the contestation process or processes selected by the taxpayer are completed. Since a conciliation conference, a hearing, or a conciliation conference followed by a hearing may take months to complete, it is possible that significant time may elapse from the time an adjustment is entered into the system until the time that DOF can demand payment and engage in collection enforcement, and the assessment may be overturned as a result of a legal proceeding. DOF found a case cited by the Comptroller's Office that is pending at the Tax Appeals Tribunal with an adjustment of \$5.7 million. We also identified two cases cited by the Comptroller's Office that are both pending in DOF's Conciliation Bureau with adjustments of \$1 million and \$5.8 million, respectively.

Another integral part of tax compliance administration is levying the correct amount of additional tax owed independent of the taxpayer's financial status. But a taxpayer's financial status is a critical factor in determining DOF's ability to collect. For example, our auditors are trained to apply the law to determine the correct amount of tax when taxpayers have filed for bankruptcy. DOF will determine the taxpayer's total liability and file an appropriate claim in bankruptcy court despite DOF likely only receiving a fraction of the assessment when the court decides on reimbursement of the taxpayer's creditors. Among the cases cited by the Comptroller's office, DOF identified a company with a \$2 million assessment whose case is on hold pursuant to a bankruptcy filing. DOF also identified four associated entities with liabilities exceeding \$26 million whose ability to pay are affected by liquidation proceedings and whose cases are being overseen by the City's Law Department.

Similarly, Fairtax automatically assesses taxpayers for late filing, late payment, or underpayment of estimated taxes for all taxpayers who incur these liabilities. In some instances, taxpayers file final tax returns after they have ceased operations and no assets remain to pay these types of tax assessments. In other instances, a taxpayer may go out of business shortly after incurring an automated assessment. The taxpayer's financial status does not determine the amount he or she may owe, but it is an important factor in DOF's ability to collect an amount owed.

"Not in real-time"

The fact and conclusion starting at the bottom of page 6 of the Draft Report are incorrect. The "fact" that real-time updates from PASS and or RID to Fairtax do not occur does NOT mean that "...Fairtax could not be used as an effective tool for collecting outstanding balances since the status of the accounts may not have been up to date". The "delay" written about in no way

inhibits the ability to collect, and the delay is not a substantial one as updates to the system are made on a frequent and ongoing daily basis. The audit report appears to assume that reliance upon an overnight batch process instead of “real time” updates explains uncollected system adjustments. But adjustments must be followed by statutory notices before DOF may collect and collection is not possible against taxpayers without assets.

“14 percent to Collections”

As indicated above, since DOF gets the vast majority of taxpayers to agree to audit findings and cases that are not agreed to can take months or years to resolve legally, taking a one-time snapshot of audit adjustments will not provide accurate data on finalized, unpaid assessments that are transferred from the Audit division to Collections. Furthermore, the Comptroller’s Office methodology severely distorts the referral rate of open liabilities to the Collections Division. Not only does the draft audit report erroneously include as open liabilities adjustments that were not yet finalized or were contested by taxpayers, it also ignores cases that were referred to the Collections Division and successfully resolved through payment or adjustment. The case balances of these cases were zero as of the time the Comptroller’s Office selected its sample.

DOF also found that many of the cases that the Comptroller’s Audit reported as not being referred to Collections were referred. The case for \$2 million referenced above was referred to Collections prior to DOF learning of the bankruptcy filing. A \$3.2 million assessment against a company was referred to Collections in February 2015. Most of the assessment was rescinded due to adjustment to the recorded “in date” of the return and a remaining balance of nearly \$88,000 was paid. Collections also received five separate cases pertaining to a dissolved company totaling over \$1.6 million. Another large case recently paid DOF \$583,000 in response to our collection efforts.

“Reason Codes”

We appreciate the Comptroller's finding that general corporation tax entries are done in a secure environment. We agree that all adjustments should have a reason code for control purposes and that a reason code of "other" must not be used. However, in interacting with taxpayers, DOF typically describes the type of automated penalty assessed or the audit issue as indicated on the notice of determination. Also, DOF did err in informing the auditors that batch process adjustments are always indicated by a "BF" prefix in the Updated By field. When the generation of a notice causes Fairtax to update penalties and interest, the notice identification number is automatically populated into the Update By field.

Separate billings

The report cites the “fact” that tax bills reflect only the current year and not cumulative taxpayer amounts due, as a possible weakness in processes. If a taxpayer has finalized tax debt owed for multiple years, the debt for multiple years can be addressed together. But frequently, taxpayer balances for different tax years have different legal statuses. The numeric example of a taxpayer making a 2013 payment while still owing 2012 and 2011 amounts due was explained to the Comptroller during the exit conference. We indicated to the auditors that we cannot legally

reassign estimated tax payments for a current tax year to satisfy a liability for a prior period. Although amounts due are noticed and demanded by tax year, the fact that the amounts are not consolidated does not represent a systematic weakness. Indeed, we explained that taxpayer's rights and other administrative reasons compel us to keep billing records by tax year and by amounts determined by period. This in no way inhibits collection or correspondence and timely communication with taxpayers.

DOF Responses to Recommendations

1. DOF should ensure that Fairtax or any successor system has embedded modules to track GCT accounts in real-time, until paid or otherwise resolved.

DOF partially agrees. Since all computer system adjustments must be followed by a statutory notice before DOF may begin collection efforts, there is no collection benefit to having a system that makes adjustments in real time compared to an overnight batch process. In many instances, a taxpayer may exercise its rights to contest tax adjustments even after a statutory notice is issued. DOF generally is interested in reducing its reliance on batch processing to increase the efficiency of its computer systems. However, the Business Tax System that has replaced Fairtax as DOF's payment operations system for corporate income tax purposes does rely on batch processing.

2. DOF should reassess its process for reviewing and collecting outstanding balances owed to the City in order to expedite collection efforts and to make GCT data in Fairtax or any successor system more reliable.

DOF strongly disagrees with the Comptroller's Office assumption that as soon as adjustments are entered into a computer system, the amounts constitute outstanding balances owed to the City. DOF may update or correct preliminary assessments. Assessments also may be reduced or eliminated through due process vehicles such as conciliation conferences or tax tribunal hearings. DOF's primary concern is complying with legal mandates and respecting the rights of taxpayers. DOF is working to fully leverage the functions of BTS to enhance its collections of adjustments that are properly referred to Collections.

3. DOF should ensure Fairtax or any successor system has the capability to display taxpayer's cumulative balances in real time and to automatically transmit invoices that reflect cumulative balances.

DOF partially agrees. As noted above, there is no collection advantage to processing an adjustment in real time when a statutory notice finalizing an assessment must be mailed to a taxpayer before collection proceedings may begin. DOF does agree that there is a need to display cumulative balances on its computer systems for collection purposes, but only for tax assessments that have been statutorily fixed.

4. DOF should review all accounts with missing RSN, RSN descriptions, and/or approvals to ensure that they were appropriately adjusted.

DOF agrees with this recommendation. We are working to ensure that all adjustments entered into BTS have an appropriate reason code.

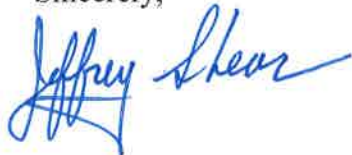
5. DOF should ensure Fairtax or any successor system has proper technical controls (i.e. mandatory fields) prior to accepting manual adjustments.

DOF agrees with this recommendation. We are reviewing BTS to ensure that all manual adjustments have proper technical controls.

6. DOF should ensure that all manual adjustments include a RSN, RSN description, and proper approvals in Fairtax or any successor system.

DOF agrees with this recommendation.

Sincerely,



Jeffrey Shear
Deputy Commissioner, Treasury and Payment Services

cc: Michael Hyman, First Deputy Commissioner
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