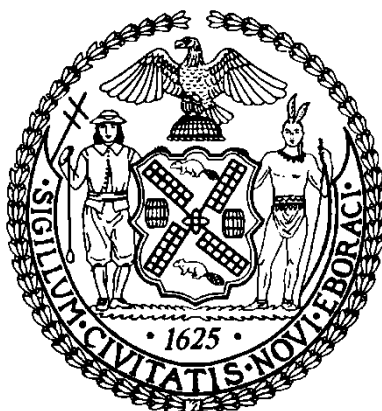


**CITY OF NEW YORK
OFFICE OF THE COMPTROLLER**

**John C. Liu
COMPTROLLER**

IT Audit and Research

**H. Tina Kim
Deputy Comptroller for Audit**



**Audit Report on the Reliability and
Accuracy of Utility Tax Data
Administered by the Department of Finance**

7A10-078

January 26, 2011



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

John C. Liu
COMPTROLLER

January 26, 2011

To the Residents of the City of New York

My office has audited the Department of Finance (DOF) to determine whether the agency's utility tax (UTX) data exists in a secure environment and is sufficiently reliable and accurate for collection purposes. We audit entities such as DOF as a means of ensuring that systems and technological resources of City agencies are cost-effective, efficient, secure, and operate in the best interest of the public.

The UTX data exists in a secure environment and is readily accessible to all essential users identified by DOF. The UTX data is generally accurate and reliable for collection purposes and generally contains the required information for enforcement and penalty collection purposes. However, the DOF Fairtax system does not capture the "final return" indicator on the UTX forms, which is intended to notify DOF that a company is no longer in business. The audit identified an outstanding unpaid balance of \$2.1 million owed to the City, and found an additional \$469,740 in revenue loss due to missing filing transactions. The Audit also noted that UTX billing periods are kept independent of each other, possibly hampering collection efforts. The audit contains three recommendations that if implemented should increase reserves and improve compliance.

The results of the audit have been discussed with 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 e-mail my audit bureau at audit@Comptroller.nyc.gov.

Sincerely,



John C. Liu

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*The City of New York
Office of the Comptroller
IT Audit and Research*

**Audit Report on the Reliability and
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7A10-078

AUDIT REPORT IN BRIEF

The Department of Finance (DOF) collects City revenues, and encourages compliance with City tax and other revenue laws. The Utility tax (UTX) is imposed on every utility and vendor of utility services that does business in New York City. “Utilities” are defined as companies that are subject to the supervision of the New York State Public Service Commission. They include gas and electric companies, telephone companies, and certain transportation companies. Additionally, companies that derive 80 percent or more of their gross receipts from mobile telecommunication services are also considered utilities.

UTX tax returns are due monthly, by the 25th of each month, covering gross income or gross operating income for the preceding calendar month. However, a taxpayer whose prior year’s tax liability was less than \$100,000 is permitted to file a semiannual UTX return for the next year. The Bank of America processes the payments and sends an electronic file to DOF. DOF personnel upload the electronic file to the Fairtax system. DOF received \$1.15 billion in UTX revenues from Fiscal Year 2007 to Fiscal Year 2009.

Audit Findings and Conclusions

The UTX data exists in a secure environment, and it is readily accessible to all essential users identified by DOF. The UTX data is generally accurate and reliable for collection purposes, and it generally contains the required information for enforcement and penalty collection purposes. However, the DOF Fairtax system does not capture the “final return” indicator on the UTX forms, which is intended to notify DOF that the company is no longer in business.

While conducting the tests that addressed the objectives to this audit, we identified an outstanding unpaid balance of \$2.1 million owed to the City. We also noted that UTX billing periods are kept independent of each other. As a consequence, previous period balances are not carried over to the next billing period, which may hamper collection efforts. Further, we found an additional \$469,740 in revenue loss due to missing filing transactions.

Audit Recommendations

To address these issues, we make three recommendations, that DOF should:

- Collect the outstanding taxes due from prior periods and from the filing periods for which returns and payments were not received.
- Ensure that the billing process is corrected by developing a mechanism to check that there are no filing periods lacking returns and that account balances are carried forward.
- Ensure the “final return” indicator field is captured in Fairtax.

INTRODUCTION

Background

The Department of Finance (DOF) collects City revenues, and encourages compliance with City tax and other revenue laws. The Utility tax (UTX) is imposed on every utility and vendor of utility services that does business in New York City. The City recognized \$398 million in revenue from UTX for Fiscal Year 2009; “Utilities” are defined as companies that are subject to the supervision of the New York State Public Service Commission (PSC). They include gas and electric companies, telephone companies, and certain transportation companies. Additionally, companies that derive 80 percent or more of their gross receipts from mobile telecommunication services are also considered utilities. These mobile telecommunication service companies do not have to be supervised by the PSC to be considered a utility. Vendors of utility services sell gas, electricity, steam, water, refrigeration, or telecommunication services; or vendors that operate omnibuses, whether or not the activities represent their primary business.

UTX tax returns are due monthly, by the 25th of each month, covering gross income or gross operating income for the preceding calendar month. However, a taxpayer whose prior year’s tax liability was less than \$100,000 is permitted to file a semiannual UTX return for the next year on the 25th of July and the 25th of January covering a six-month tax period of January–June and July–December. The basic UTX rate is 2.35 percent on the gross income of taxpayer. However, different rates apply to bus companies and railroads (see Table I). If the tax is not paid on or before the due date, interest and penalties must be paid on the amount of the underpayment from the due date to the date paid. Effective in tax year 2009, refunds for the UTX may be requested within three years from the time a utility tax return is filed and two years from the time the tax is paid.

Table I
UTX Tax Rates

BUSINESS TYPE	TAX RATE
Utilities	2.35 percent of gross income
Omnibus operators subject to NYS Department of Public Service supervision	1.17 percent of gross income
Railroads	3.52 percent of gross income
Vendors of utility services	2.35 percent of gross operating income
Omnibus operators who are not subject to NYS Dept. of Public Service supervision	1.17 percent of gross operating income
Limited fare omnibus companies:	
Commuter service	0.10 percent of gross income
Other services	1.17 percent of gross income

The UTX is divided into three categories¹: UXS,² UXP,³ and UXRB.⁴ UTX forms can be found on the DOF Web site for new filers. All others receive a pre-printed form by mail, but they can fill out and submit the form online if they choose. Account holders compute their own tax due based on the gross income they stated and their answers to the “Computation of Amount Due” section of the form. DOF’s Fairtax system computes the tax due for an account holder independently of the amount that the account holder asserts as tax due on the form. If the discrepancy is greater than \$5.00, DOF bills the taxpayers for the difference. If the account holders overpaid, they are entitled to a refund. Forms and payments are mailed to a lockbox.

When payment is made by check, the check is mailed to the lockbox, which is administered by Bank of America (payments are not accepted in person). The bank enters the taxpayer information in its system and sends the electronic file twice a week to the DOF Financial Information Technology Unit (FIT). DOF personnel upload the electronic file to Fairtax. The bank also scans the forms, checks, and envelopes, and uploads the images to Filenet.⁵ DOF employees can view the images on Filenet. DOF received \$1.15 billion⁶ in UTX revenues from Fiscal Year 2007 to Fiscal Year 2009.

Objectives

To determine whether the UTX data:

1. Exists in a secure environment, and is readily accessible to all essential users;
2. Contains accurate information;
3. Is sufficiently reliable for collection purposes, and;
4. Contains required information for enforcement and penalty collection process.

Scope and Methodology

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and

¹ Each category requires its own form.

² For use by persons (other than a limited-fare omnibus company) not subject to the supervision of the New York State Department of Public Service who furnish or sell utility services or operate omnibuses. Example: a hotel.

³ For use by utilities other than railroads, bus companies, and other common carriers. Example: Con Edison. These utilities file electronically and paid the most tax during the period audited.

⁴ For use by railroads, bus companies, and other common carriers other than trucking companies.

⁵ Filenet is software used by DOF employees to view on their computer a copy of a taxpayer’s forms and payments. Bank employee access (via user ID) to Filenet needs to be approved by the DOF Personnel unit??. The Filenet software is owned by DOF, but it is the Bank of America that scans the information to Filenet. Filenet data is kept for 10 years.

⁶ DOF received \$398 million for Fiscal Year 2009, \$392 million for Fiscal Year 2008, and \$360 million for Fiscal Year 2007.

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.

Our fieldwork was conducted from September 2009 to July 2010. To achieve our audit objectives we:

- Interviewed various DOF officials from the Discrepancy and Billing Unit, Payment Operations unit, Automated processing unit, Collection unit, and the Finance Information Technology unit;
- Conducted a system walk-through on February 3, 2010, to gain an understanding of the administration of the UTX;
- Reviewed and we analyzed DOF *Security Guidelines and Policy and Standard Operating Procedures Mainframe Security Policy* to determine whether DOF policy and its procedures provide adequate security controls;
- Requested a complete list of essential personnel who were granted access to UTX to determine whether their access privileges were appropriate, and whether UTX data is readily accessible to all essential personnel. DOF provided a list of 13 users it considered essential. These 13 users are assigned specifically to work with UTX data, and they are authorized to modify information on the system;

We received the UTX data file from DOF on February 9, 2010, for UTX accounts (UXP, UXR, UXS) for calendar years 2007 to 2009. We performed several frequency distributions to identify duplicate data, and we created a separate data file with no duplicate data. Using this file to determine the accuracy of the data,⁷ we:

- Performed queries to ascertain whether critical data needed for billing and collection purposes was missing, including, EIN, account ID, owner's name and business address, and gross income;
- Tested for invalid dates;
- Ran queries for all outstanding balances for UTX accounts and a query for all overpayment balances to determine whether any underpaid account had an overpayment;
- Recreated and tested the formula used to calculate penalties on delinquent accounts to verify its accuracy;
- Ran queries for all outstanding balances for UTX accounts to determine whether any actions were taken to ensure the balances outstanding were paid;

⁷ All of our tests were based on the data that we received for billing years 2007 to 2009.

- Ran queries for all UTX accounts with a total liability of zero to determine the number of taxpayers filing zero liability, to determine the reasons for filing zero liability;
- Ran queries for all accounts with a total liability for the year greater than or less than \$100,000 to determine whether the correct form was being mailed out to taxpayers;
- Identified and examined all accounts with missing filing periods to identify any discrepancies in the system;
- Identified and examined all accounts that noted an overpayment of the levy to determine how many taxpayers had made an overpayment and how many had requested a refund; and
- Identified and examined all accounts underpaid by less than \$5.

As criteria, we used the City's Department of Information Telecommunications and Technology *Citywide Information Security Directives and Policies*, and the National Institute of Standards and Technology *Generally Accepted Principles and Practices for Securing Information Technology System*.

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 sent to DOF officials and was discussed during an exit conference held on September 22, 2010. On September 24, 2010, we submitted a draft report to DOF officials with a request for comments. We received a written response from DOF on October 8, 2010. In their response, DOF officials agreed with two recommendations, and partially agreed with one recommendation.

The full text of the DOF response is included as an addendum to this final report.

FINDINGS AND RECOMMENDATIONS

The UTX data exists in a secure environment, and it is readily accessible to all essential users identified by DOF. The UTX data is generally accurate and reliable for collection purposes, and it generally contains the required information for enforcement and penalty collection purposes. However, the DOF Fairtax system does not capture the “final return” indicator noted on the UTX forms, which is intended to notify DOF that the company is no longer in business.

While conducting the tests that addressed the objectives to this audit, we identified an outstanding unpaid balance of \$2.1 million owed to the City. We also noted that UTX billing periods are kept independent of each other. As a consequence, previous period balances are not carried over to the next billing period, which may hamper collection efforts. Further, we found an additional \$469,740⁸ in revenue loss due to missing filing transactions.

Process Control Weaknesses

When analyzing the UTX data file and conducting our tests to address the objectives of this audit, we noted a number of control weaknesses over the data. Specifically, we found that data for UTX account periods are kept independent for each billing cycle period. As a result, previous balances are not carried over to the next billing period. We also discovered an outstanding balance of \$2.1 million. In addition, we found a revenue loss of approximately \$469,740 due to missing filing transactions. We also noted that the DOF Fairtax system does not capture the “final return”⁹ indicator on the UTX forms.

Outstanding Balances of \$2.1 Million Owed to the City

During our testing period, we uncovered an outstanding tax balance totaling \$2.1 million for the period covering calendar years 2007 through 2009 (see Table II). We analyzed and found that 34 of 97 total underpaid transactions originated from DOF’s Audit Division.

Table II
UTX Outstanding Balances

UTX Account Year	# of Underpaid Transactions	Outstanding Balances
2007	40	\$1,003,616.43
2008	32	\$799,150.97
2009	25	\$301,738.22
Total	97	\$2,104,505.62

Taxpayers who have not paid their UTX within two to three weeks after it is due receive a Notice of Tax Due with interest and penalties. If, after 6 weeks of receiving the Notice of Tax Due, the taxpayer has not paid the tax liability, then the taxpayer will receive a Notice and

⁸ Approximated.

⁹ “Final Return” is an indicator on the UTX forms that informs DOF that the taxpayer is no longer in business.

Demand for Payment Due. If the notice goes unanswered, the case will be referred to DOF's Collections Division. The Collections unit initiates a dunning process through auto dial telephone calls. When the DOF Collections unit reviews the delinquent accounts, it determines whether to issue a warrant. When a warrant is issued, the Collections unit can then take enforcement action. New York State law permits DOF to issue a warrant for collection of delinquent accounts for up to six years.

Account Periods Are Maintained Independently

While reviewing UTX data, we noted that delinquent balances from previous billing periods are not carried over to the next billing period. For example, account holders whose accounts are delinquent for the period ending June 1, 2007, are allowed to send a payment for the period of July 1, 2007, but leave the outstanding June 1, 2007 balance unpaid. The Fairtax UTX program was designed to keep each account's billing periods separate from each other. DOF's practice of not carrying over an account's delinquent balance from a previous period encourages taxpayers to forgo paying earlier delinquent account balances and also may hamper collection efforts.

Revenue Loss Due to Failure to Identify UTX Forms and Payments Never Received

While reviewing UTX data, we noted that 28 taxpayer accounts lacked filing transaction returns. Depending on the taxpayer's total gross income, taxpayers paid the UTX monthly or semi-annually. During testing, we found 28 taxpayer accounts that lacked filing transaction returns. For example, a monthly taxpayer submitted UTX forms and payments for October 2009 and December 2009, but there was no filing transaction return or accompanying payment for November 2009. Although DOF sent out pre-printed UTX forms, these 28 taxpayers did not return the forms or payment. DOF does not have a control in place to monitor and to follow up on filing transactions that have not been submitted. This resulted in an additional tax revenue loss of approximately \$469,740 based on DOF's calculations of the tax that was due.

Fairtax Does Not Capture "Final Return" Indicator

All existing UTX taxpayers are sent a pre-printed UTX form. The pre-printed form includes the following data prepopulated: name, address, date, EIN/SSN, account type, account ID, period begin, period end, and due date. The bottom portion of the form labeled "schedule A – computation of gross income" is left blank for the taxpayer to fill-out. The form also contains a "final return" box that taxpayers can check off to notify DOF that they are no longer in business. The Bank of America will forward all the information on the UTX forms to DOF. All existing accounts will continue to receive pre-printed UTX forms from the DOF. However, we found that the final return information was not updated in Fairtax. As a result, the taxpayers' information is also not accurately maintained and up-to-date in Fairtax. As a consequence, DOF continuously generated UTX forms to inactive taxpayers.

Recommendations

DOF should:

1. Collect the outstanding taxes due from prior periods and from the filing periods for which returns and payments were not received.

DOF Response: DOF partially agreed with this recommendation and stated, “The prior period utility tax is not rolled into subsequent period tax bill because of the design of the Fairtax billing system. Fairtax offers no capacity for us to carry over previous UTX balances into current periods. Our IT Department has advised that Fairtax could not be recoded to add this functionality without rewriting the entire payment application system. Because of the complexity of solving this issue through Fairtax, Finance will review whether there are any other additional methodologies necessary to ensure we collect all past due amounts from entities paying their taxes on a current basis.”

Auditor Comment: DOF should expedite the review and develop a comprehensive process to collect the outstanding taxes due from prior periods and the missing filing periods. Also, DOF should ensure that this problem does not occur again.

2. Ensure that the billing process is corrected by developing a mechanism to check that there are no filing periods lacking returns and that account balances are carried forward.

DOF Response: DOF agreed with this recommendation.

3. Ensure the “final return” indicator field is captured in Fairtax.

DOF Response: DOF agreed with this recommendation.



David M. Frankel
Commissioner

October 8, 2010

Elizabeth D. Botwin
Deputy Commissioner
Administration & Planning
BotwinE@Finance.nyc.gov

Hon. Tina Kim
Deputy Comptroller for Audit
One Centre Street, 11th Floor
New York, NY 10007
Sent via e-mail: tkim@comptroller.nyc.gov

1 Centre Street
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New York, NY 10007

**Re: Audit Report on the Reliability and Accuracy of Utility Tax Data
Administered by the Department of Finance (7A10-078)**

+1 212 669 7605 tel
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Dear Deputy Comptroller Kim:

Thank you for the opportunity to provide the Department of Finance's official response to the above-referenced draft audit, dated September 24, 2010.

As I underscored when we have met, Finance welcomes the opportunity to be audited on its programs. In addition to the valuable feedback that this specific audit provided, we very much appreciate that it was conducted quickly and efficiently, with very minimal disruption of staff work.

The following responds to each of your recommendations:

Recommendation 1: Collect the outstanding taxes due from prior periods and from the filing periods for which returns and payments were not. Finance partially agrees.

We agree with the spirit of this recommendation. As an agency, it is our job to have taxpayers pay their taxes in full. As the City Comptroller aptly points out, Finance has a billing process in place for utility tax balances due. We mail two pre-docket tax notices, and if they remain unpaid, Finance will docket a tax warrant, ultimately giving us the power to seize business assets and restrain a debtor's bank accounts.



The prior period utility tax is not rolled into a subsequent period tax bill because of the design of the Fairtax billing system. Fairtax offers no capacity for us to carry over previous UTX balances into current periods. Our IT Department has advised that Fairtax could not be recoded to add this functionality without rewriting the entire payment application system. Because of the complexity of solving this issue through Fairtax, Finance will review whether there are any other additional methodologies necessary to ensure we collect all past due amounts from entities paying their taxes on a current basis.

The delinquent UTX balances identified by the audit -- \$2.1 million out of approximately \$1.2 billion collected during the audit period, or a .02% delinquency rate, are overstated. Only \$1.2 million of that amount was immediately due. As we documented at the exit conference, \$862,000 of the \$2.1 million represents assessments by Finance's Audit division that had not yet been finalized as of the audit request date.

Recommendation 2: Ensure that the billing process is corrected by developing a mechanism to check that there are no filing periods lacking returns and that account balances are carried forward.

Finance agrees.

We agree with this finding. We have fixed the programming error that failed to detect unfiled monthly UTX returns and will issue delinquency notices for the 28 monthly periods. Those taxpayers will be required to file the missing returns and pay the resulting tax, penalty and interest amounts due.

Recommendation 3: Ensure the "final return" indicator field is captured in Fairtax.

Finance agrees.

As with Recommendation #2, an administrative solution to this problem is also in progress. As a result, Fairtax will capture all "final return indicator" fields specified on filed returns by January 2011. This will prospectively eliminate the mailing of delinquency notices to taxpayers who are not required to file returns.



Conclusion

As we have outlined above, this audit has proven helpful to us, by identifying specific administrative problem areas within the Utility Tax that required our attention.

If you have any specific questions about this response, please feel free to get back in touch with me.

Sincerely,

A handwritten signature in black ink, appearing to read "Elizabeth Botwin".

Elizabeth Botwin

- C: George Davis III, Mayor's Office of Operations
David M. Frankel, Commissioner, NYC Department of Finance
Michael Hyman, Deputy Commissioner, Tax Policy and Planning
Beth Goldman, General Counsel
Andrew Salkin, Deputy Commissioner, Operations
Leslie Zimmerman, Assistant Commissioner, Payment Operations
Christopher Browne, Assistant Commissioner, Communications & Government Affairs