Department of the Treasury
Division of Taxation

July 1, 1996 to July 31, 1998
Enclosed is our report on the audit of the Department of the Treasury, Division of Taxation for the period July 1, 1996 to July 31, 1998.

If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair
State Auditor
September 24, 1998
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Department of the Treasury
Division of Taxation

Scope

We have completed an audit of the Department of the Treasury, Division of Taxation for the period July 1, 1996 through July 31, 1998. Our audit included financial activities accounted for in the state’s General Fund.

The prime responsibility of the Department of the Treasury, Division of Taxation is to administer the state’s tax laws uniformly, equitably and efficiently to maximize state revenues and to ensure that voluntary compliance within the taxing statutes is achieved. Tax revenue is generally collected and processed by the Division of Revenue. The Division of Taxation handles collections from compliance efforts and tax administration. The division consists of seven units of operation: Field Audit, Office Audit, Technical Services, Chief of Staff, Compliance, Property Administration and the Office of Technical Support. Collections from the compliance efforts of the agency total approximately $530 million per year. The major contributors of revenue were audit functions and the collection of outstanding tax liabilities.

The division also collects and distributes the Public Utility Tax which totals approximately $1 billion per year. Effective fiscal year 1998, legislation altered the basis for this tax. Our audit was limited to obtaining an understanding of internal controls related to the methodology under the new tax law.

Objectives

The objectives of our audit were to determine whether financial transactions were related to the agency’s programs, were reasonable and were recorded properly in the accounting systems. We also tested for resolution of significant conditions noted in our prior report.
The Office of Technical Support is responsible for system programming and support and was included in the scope of our EDP audit titled *Department of the Treasury, Office of Telecommunications and Information Systems, Division of Taxation’s Computer Systems (TAXNET)* issued July 17, 1998. These reports should be read in conjunction with one another.

The Property Administration Unit has three units which support local property tax assessment compliance and policy/planning issues. They help to develop an annual table of equalized valuation used to calculate and distribute state school aid. While the dollars involved are significant they are not disbursed by the Division of Taxation and were not included in our audit work.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

**Methodology**

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview and observation and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed agency personnel to obtain an understanding of the programs and the internal control structure.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample transactions were judgmentally selected. Our tests of audits completed by field audit units excluded out of state offices.

To ascertain the status of findings included in our prior report, we identified corrective action, if any, taken by
the agency and walked through the system to determine if the corrective action was effective.

**Conclusions**

We found that the financial transactions included in our testing were related to the agency's programs, were reasonable and were recorded properly in the accounting systems. In making this determination, we noted certain internal control weaknesses and matters of compliance with laws and regulations meriting management’s attention.

We also found that the agency has resolved the significant issues noted in our prior report except for a matter related to the adequate segregation of duties for the processing of returned/undeliverable refund checks. This issue has been updated and restated in our current report.
Unclaimed Property Transfers

Account balances created by returned checks should be transferred to the Unclaimed Personal Property Trust Fund.

Our review of procedures in place to process and redeposit returned checks by the division noted numerous positive taxpayer account balances which had not been forwarded to the Unclaimed Personal Property Trust Fund. This fund was established to receive personal property deemed abandoned by but still due to the owners. A summary of the five year period from calendar year 1991 to 1995 showed approximately $15.9 million in unclaimed accounts. During our audit, the division obtained an Attorney General’s opinion which states that the accounts do qualify as unclaimed property.

Taxpayers entitled to an income tax refund or homestead rebate are not notified that a balance exists in their account, even though in some cases a scanning or keypunch error may have been the reason for the error in delivery. The Taxpayer Accounting Unit, which is responsible for the processing and redepositing of returned checks, explained that they did not have sufficient personnel resources to research each returned item for correction.

Recommendation

We recommend the division review taxpayer files in existence for the homestead rebate and income tax accounts. Where positive balances exist in the taxpayer’s account, the division should take the necessary steps to transfer the account balance to the Unclaimed Personal Property Trust Fund in accordance with P.L.1989, c.58.

Auditee’s Response

Meetings have been held with personnel from Unclaimed Property to identify the requirements to transfer GENTS redeposited refunds to Unclaimed Property. Refund (rebate) checks for all GENTS taxes issued at least one year prior to the start of the current fiscal year qualify as abandoned property and will be transferred to Unclaimed Property. The initial run will include all checks issued prior to July 1, 1997. Subsequent runs will be scheduled as appropriate. A credit transaction will be posted to the taxpayer’s account in GENTS to identify the transfer of the redeposited check to Unclaimed Property and to reduce the amount of the
current overpayment. Subsequent payments will be issued by Unclaimed Property. A data processing request will be activated in order to implement this process.

Payment Processing Controls

Our survey and assessment disclosed a lack of segregation of duties throughout the division in the processing of taxpayer liability payments. Division staff have the ability to adjust a taxpayer’s assessment and also receive a payment directly from the taxpayer. In some cases the same employee may also have initiated the billing to the taxpayer. In addition, although checks are date stamped when received, they are not restrictively endorsed. Restrictive endorsement would make it difficult for anyone but the state to deposit the check. Adequate internal controls would include the necessary safeguards to ensure the proper handling of all cash receipt transactions. Lack of adequate internal controls in place for the processing of cash receipts could lead to undetected misappropriation of funds.

Recommendation

We recommend the division initiate controls which would require the initial processing of payments to include a procedure to open all mail and restrictively endorse all checks before distribution.

Auditee’s Response

A new procedure will be implemented to address this finding. New stamps have been ordered with the endorsement “State of New Jersey - For Deposit Only”. This endorsement will be placed on the check at the time the mail is opened and date stamped by support personnel who will then pass the check and any related correspondence to a professional or paraprofessional for processing and response.
Returned or Undeliverable Checks

Our survey and testing of procedures to process and redeposit undeliverable and returned checks by the Taxpayer Accounting Branch disclosed a lack of segregation of duties. An individual may be responsible for sorting and batching the checks and entering the redeposit transaction to the taxpayer’s account in the Generic Tax System (GENTS) without the involvement of another employee. In addition, the batch total of redeposit transactions entered in GENTS were not reconciled to the batch total of checks processed by the Division of Revenue. As a result, internal controls are inadequate and returned checks not processed properly may go undetected.

Our testing noted ten returned checks for which the redeposit entry was not made properly to GENTS, thus the checks were never posted to the taxpayers’ accounts even though the checks were redeposited. Additional analysis disclosed 61 returned Inheritance Tax checks totaling $207,019 which had not been forwarded to the Division of Revenue for redeposit into the state accounting system. The checks, dating back to fiscal year 1994, were posted to the GENTS system, voided and maintained at the Inheritance Tax Branch. The change to a new accounting system during fiscal year 1994 left the branch unsure how to process the checks to the Division of Revenue and thus they were maintained in a voided condition at the branch. As noted above, necessary safeguards to ensure the proper handling of cash receipt transactions would include the timely redeposit of the returned checks to the state accounting system.

Recommendation

We recommend the Taxpayer Accounting Branch initiate controls which allow for a segregation of duties between the sorting and batching functions and the processing of redeposit entries on the GENTS system for all returned checks received. Also, we recommend the branch reconcile checks redeposited to the GENTS system with the total number processed by the Division of Revenue. The Inheritance Tax Branch should take the steps necessary to ensure timely redeposit of all returned checks received.
Auditee’s Response

The current processing procedures for returned refund checks requires that the checks be logged into a book which summarizes the checks into yearly groups. These groupings are assigned transmittal numbers, also within the logbook.

NJCFs transmittal entry documents are then prepared and GE 21 Refund Redeposit entries into GENTS are completed. At this time, on line NJCFs entries are made from the previously prepared transmittal documents and placed on “Hold Status”.

The checks and related transmittal documents are then forwarded to Revenue for their processing. This includes the actual deposit of the checks and update to the CRAS cashbooks. Once Revenue has completed their work, they remove the “Hold Status” from the appropriate NJCFs electronic transmittal entries and the process is then complete.

To ensure that the refund redeposits are made into GENTS, a new maintenance report will be generated daily identifying all GENTS redeposit entries for reconciliation with the log book. In addition, any transmittal work not completed by the Division of Revenue could be recognized by periodically reviewing the “Hold Status” entries in the NJCFs system.
Additional refunds generated using “suspense” transactions do not require supervisory approval.

Gents Suspense File Refund Transactions

The division uses “suspense transactions” to edit a taxpayer’s account, a line on a tax return or an entire return. Our testing of cash receipts disclosed an instance in which the use of suspense transactions enabled a technician to generate a duplicate Homestead Rebate check to a taxpayer. The transaction, in which an existing refund line item was moved to suspense in order to allow a second refund in the taxpayers account, was completed by a technician and required no supervisory approval to process. Supervisors are provided daily reports of all refunds generated, but the report does not indicate that a refund was generated specifically from suspense transactions. The lack of a system control requiring the supervisor to approve all suspense transactions where a refund has been transferred to create a second refund in the same taxpayer account allows for the possibility of a misappropriation of funds. Adequate internal control procedures would require an appropriate level of segregation in the generation of refunds using suspense transactions.

Recommendation

We recommend the division institute system reports to identify suspense transactions in which a refund is transferred allowing a second refund to be created in the same taxpayer account. Also, procedures should require documented supervisory approval for all such transactions processed.

Auditee’s Response

An emergency data processing request was activated and sent to OTIS on September 9, 1998 to generate a separate listing of all refund transactions that are transferred individually to suspense, thus creating an overpayment in the taxpayer’s account. This listing is in addition to the GENTS daily maintenance report that identifies daily on-line activity (line item adjustments, transfers, applied date changes, abatements, etc.) by location and employee.
Seized Property

Seized property inventory records should be verified by the taxpayer.

Recommendation

We recommend the division adjust their Field Investigation Branch inventory documents to include the signature of the taxpayer thus providing an adequate level of verification to the inventory listing.

Auditee’s Response

The recommendation as written will be implemented.

1995 Homestead Rebate System Purge

System program deficiencies allowed for inappropriate purging of Homestead Rebate account balances.

During our analysis of cash receipts, we attempted to trace the partial payment of a homestead rebate billing to the taxpayers account in GENTS only to find that the account balance had been purged. When this was brought to the division’s attention, it was found that there were two deficiencies in the homestead rebate purge program. Files with balances greater than $24.99 or less than negative $24.99 should not have been purged but rather should have been transferred to the out of balance file. This criteria had not been entered into the homestead rebate purge program which allowed all files, regardless of balances, to be purged. The second deficiency was that the purge run had not been updated for billing status code changes (APP to AP1) to reflect new billing information. This allowed currently billed accounts to be purged from the system. Both of these problems have since been described by the division to the Office of Telecommunication and Information Systems (OTIS) for correction and taxpayer accounts have been reactivated.
Recommendation

We recommend that the Homestead Rebate purge program be updated to reflect the criteria that was previously omitted.

Auditee’s Response

A data processing request was activated and sent to OTIS on June 2, 1998 to modify the purge criteria for Homestead Rebate. Specifically, the designated over/under amount, currently plus or minus $24.99, will be checked prior to purging an account and the status code for bill transactions will be modified from ‘APP’ to ‘AP1’ in order to identify current billing activity. The twenty Homestead Rebate records that were erroneously purged were identified and reactivated on July 17, 1998. All other criteria to bypass overpaid accounts and accounts with billing activity to remain in effect.