



**New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor**

**Department of the Treasury
Division of Taxation**

July 1, 2007 to June 18, 2010

Stephen M. Eells
State Auditor

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New Jersey State Legislature

OFFICE OF LEGISLATIVE SERVICES
OFFICE OF THE STATE AUDITOR
125 SOUTH WARREN STREET
PO BOX 067
TRENTON NJ 08625-0067

ALBERT PORRONI
Executive Director
(609) 292-4625

OFFICE OF THE STATE AUDITOR
(609) 292-3700
FAX (609) 633-0834

STEPHEN M. EELLS
State Auditor

THOMAS R. MISEROLI
Assistant State Auditor

JOHN J. TERMYNA
Assistant State Auditor

The Honorable Chris Christie
Governor of New Jersey

The Honorable Stephen M. Sweeney
President of the Senate

The Honorable Sheila Y. Oliver
Speaker of the General Assembly

Mr. Albert Porroni
Executive Director
Office of Legislative Services

Enclosed is our report on the audit of the Department of the Treasury, Division of Taxation for the period of July 1, 2007 to June 18, 2010. If you would like a personal briefing, please call me at (609) 292-3700.

Stephen M. Eells
State Auditor
October 8, 2010

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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 (division) for the period July 1, 2007 to June 18, 2010. The division's mission is to administer the state's tax laws uniformly, equitably, and efficiently to maximize state revenues to support public services; and to ensure that voluntary compliance within the taxing statutes is achieved without being an impediment to economic growth. Our audit focused on the Unclaimed Property Branch, the Conference and Appeals Branch, professional service contracts, and tax amnesty. The Unclaimed Property Branch became Unclaimed Property Administration, an agency separate from the division, during fiscal year 2010.

Objectives

The objectives of our audit were to determine whether the programs and activities related to the Unclaimed Property Branch, the Conference and Appeals Branch, professional service contracts, and tax amnesty were effectively administered and whether financial transactions were recorded properly in the accounting systems. This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section I, 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 Department of the Treasury, and policies of the division. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget messages, reviewed financial trends, and interviewed agency personnel to obtain an

understanding of the programs and the internal controls. We analyzed internal data sources through queries and matches.

A statistical and 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 populations were sorted and transactions were randomly and judgmentally selected for testing.

Conclusions

We commend the division on their ability to efficiently operate with limited resources and their ability to meet time-sensitive project demands. We found that the programs and activities related to the Unclaimed Property Branch, the Conference and Appeals Branch, and professional service contracts were effectively administered and financial transactions were recorded properly in the accounting systems. However, we were unable to determine the effectiveness of the tax amnesty program as amnesty transactions were not always properly recorded in the subsidiary accounting systems. The lack of uniformity in recording procedures for the amnesty program prevented the reconciliation of the total amnesty collections and determining the abatement amounts. As a result, the effectiveness of the program cannot be determined. Also, we noted an excessive backlog of cases within the Conference and Appeals Branch.

Tax Amnesty

Amnesty collection and abatement data is not accessible for analysis.

A tax amnesty program is a limited time opportunity that allows taxpayers to pay taxes owed and to file late returns without penalty and with reduced interest. For the period May 4 through June 15, 2009, legislation allowed all penalties and half of the interest owed by eligible taxpayers to be waived; however an additional five-percent penalty was to be imposed on all outstanding tax amounts after the program expired. Tax amnesty was available to individuals and businesses that owed taxes for tax returns due on or after January 1, 2002 and before February 1, 2009. This is the fourth tax amnesty program instituted by the State of New Jersey since 1987.

A complete assessment of the tax amnesty program cannot be performed because of the lack of reliable system information. Per *Control Objectives for Information and Related Technology* (CobIT), section AI 2.3, Application Control and Auditability, an organization needs to implement automated application controls such that processing is accurate, complete, timely, authorized, and auditable. The use of various protocols for the processing of amnesty collections and abatements and inherent limitations of the systems' accounting for these transactions inhibited obtaining complete and accurate information on this program.

Reconciliations

The Division of Taxation (division) provided us with an amnesty revenue summary report by tax type totaling \$746 million for the program. This information was compiled by the division through data provided by the Department of the Treasury, Office of Information Technology (OIT) and other internal sources. The OIT provided amnesty collection data for electronic payment sources. Manual transactions that were collected by applicable units within the division were sourced to the summary report. During our

review of this report we made several unsuccessful attempts to reconcile this information to the Generic Tax System (GENTS) and other sources. Our reconciliation was \$52 million less than the division's summary report primarily related to GENTS. GENTS should contain the historical and current information for most taxpayers. It should be noted that the division's collection report total of \$746 million agrees with Division of Revenue's (DOR) cash reconciliation. DOR reconciled its amnesty collections to its Cash Receipt Accounting System totals, but the individual transaction detail was unavailable for our use.

Amnesty Abatements

The division was unable to provide and we were unable to determine total abatements relating to the amnesty program. Abatement is the amount of interest and penalty that is waived for each taxpayer. Without accurate abatement data, the underlying cost of the program cannot be determined. Our audit disclosed that the systems associated with the recording of the abatement amounts, GENTS and the Taxpayer Unremitted Liability Inventory Plotting System (TULIPS), and its users, were unable to properly process transactions in accordance with the specific requirements necessary to allow for the determination of total abatement amounts.

Recommendation

We recommend a monitoring system to accurately track collections and abatements be developed prior to another amnesty program.

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Conference and Appeals Backlog

There is a significant backlog of cases within the Conference and Appeals Branch.

The Conference and Appeals Branch's objective is to provide a timely and final administrative review to taxpayers who protest or appeal determinations issued by the Division of Taxation. The branch is not meeting its objective of timely reviews. As of April 2010, there was a backlog of 1,300 cases, including approximately 500 that were unassigned. Per management, the average wait time for a case to be assigned is one and a half years, although cases have gone unassigned for up to three years. The large backlog of cases delays revenue collections. Also, taxpayers' perception of the division is damaged by the untimely response times. According to the Conference and Appeals Branch, the backlog occurs because of the unique case by case nature of the work. Employees are assigned cases that are fact and time intensive. Recently, the division introduced an initiative to address the backlog by reallocating resources to increase the number of staff available to hold conferences. At this time it is too early to determine how effective the initiative is working, but management is optimistic the backlog will be reduced by half within the first year.

Recommendation

We recommend the division continue with the initiative and monitor the progress it has made on the backlog of cases.

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State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF TAXATION
P.O. BOX 240
TRENTON, NJ 08695-0240

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

ANDREW P. SIDAMON-ERISTOFF
State Treasurer

October 7, 2010

Stephen M. Eells, State Auditor
Office of the State Auditor
125 South Warren Street, PO Box 067
Trenton, NJ 08625-0067

Re: Department of the Treasury, Division of Taxation

Dear Mr. Eells:


We appreciate the opportunity to respond to the audit findings and recommendations for the tax amnesty program and conference and appeals backlog for tax year 2009. Please understand that the Division of Taxation welcomes the input provided by the Office of the State Auditor and has every intention to implement solutions to mitigate any findings in the future.

Tax Amnesty: We at Taxation believe that it is important to understand that we rely on systems and resources outside our sphere of influence to aggregate and record transactions. During the Tax Amnesty held from May 4 to June 15, 2009, inadequate, inflexible systems presented Taxation with insurmountable challenges during a compressed timeframe. Thousands of transactions required manual handling due to the existing systems limitations. Taxation personnel developed a work-around tracking mechanism to verify amnesty related collections against cash receipts recorded at the Division of Revenue. This was verified by the report. We believe that with additional preparation and more responsive resources the indicated weaknesses related to tracking abatements can be adequately addressed.

While the report recommendation anticipates a future amnesty program, we at Taxation believe that tax amnesties create many difficulties for tax administrators that are beyond the scope of this response. It is always our goal to encourage voluntary compliance, but regular tax amnesty programs create an expectation of compromise in the taxpaying public that may otherwise never exist.

Conference and Appeals Backlog: With the oversight of a new Director we believe that several initiatives will begin to reduce the existing backlog. Additional resources in the form of personnel additions during October 2010 and additional oversight in the form of mandatory, periodic case review by supervisory personnel should have a substantial impact. We will also be evaluating settlement parameters and authority in conjunction with a fundamental restructuring to address the existing backlog.

We thank you for your input and appreciate the professionalism that your staff brought to this engagement.

Best,

Michael J. Bryan
Acting Director
Division of Taxation

c: Treasurer Andrew Sidamon-Eristoff
Chris Jeter
Dennis Shilling