

New York State Office of the State Comptroller
Thomas P. DiNapoli

Division of State Government Accountability

Controls Over Unclaimed Bottle Deposits

**Department of Taxation and
Finance**



Report 2016-S-96

December 2017

Executive Summary

Purpose

The objectives of our performance audit were to determine whether the Department of Taxation and Finance (Department) is enforcing registration and reporting requirements on deposit initiators, and is collecting and depositing the required unclaimed bottle funds into the General Fund. The audit covers the period April 1, 2014 through February 6, 2017.

Background

New York State's Returnable Container Act (Act) requires every deposit initiator to collect a 5 cent deposit on containers of less than one gallon of many beverages sold in the State, such as soft drinks and beer. Consumers may then return their empty beverage containers to a dealer or redemption center to get their deposit back. Deposit initiators are required to establish an interest-bearing refund value account (bank account) for the sole purpose of refunding deposits. The Act requires all deposit initiators registered with the Department to remit 80 percent of any unclaimed bottle deposits on a quarterly basis. Along with the remittance, deposit initiators are required to keep track of all deposits collected and file quarterly reports with the Department detailing deposits, withdrawals, interest earned, and the quarterly ending balance of the bank account. The Department has the authority to penalize deposit initiators that fail to register with the Department or fail to file quarterly reports. The Act requires all unclaimed deposits collected by the Department to be deposited in the State's General Fund. The Department collected \$109.5 million and \$102.7 million in unclaimed bottle deposits in State fiscal years 2015 and 2016, respectively.

Key Findings

- The Department deposited all funds received into the General Fund as required.
- The Department did not assess penalties on 39 deposit initiators that failed to file quarterly reports as required, and took little action to improve compliance. The Department also did not assess penalties for 301 of 539 quarterly reports that were filed late.
- The Department does not have procedures in place to verify data in the quarterly reports submitted by deposit initiators. Our analysis identified multiple red flags that may be indicative of material errors and/or fraudulent reporting. For example, some initiators report bank account service charges that are significantly higher than those reported by other initiators. The service charges reduce the amount that the initiator is required to remit to the Department. Our analysis of a judgmental sample of 82 of 612 quarterly reports showed service charges for 60 were \$100 or less, eight were from \$100 to \$500, eight were from \$500 to \$1,000, and six exceeded \$1,000.

Key Recommendations

- Assess penalties on initiators that fail to file quarterly reports.
- Review the red flags that we identified in our report and take appropriate corrective action, such as requesting supporting documentation or conducting investigations.
- Require deposit initiators to submit supporting documentation with their quarterly reports to support their reported amounts.

Other Related Audits/Reports of Interest

[Department of Taxation and Finance: Processing of Paper Tax Returns \(2013-S-64\)](#)

[Department of Taxation and Finance: Controls Over the Collection of the Public Safety Communications Surcharge \(2016-S-84\)](#)

State of New York
Office of the State Comptroller

Division of State Government Accountability

December 19, 2017

Ms. Nonie Manion
Executive Deputy Commissioner
Department of Taxation and Finance
William A. Harriman State Campus
Building 9
Albany, NY 12227

Dear Ms. Manion:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage government resources efficiently and effectively. By doing so, it provides accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities, and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit entitled *Controls Over Unclaimed Bottle Deposits*. The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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This report is also available on our website at: www.osc.state.ny.us

Background

As the tax processing agency for the State, the Department of Taxation and Finance (Department) is charged with the efficient collection of tax revenues in support of State services and programs while acting with integrity and fairness in the administration of the tax laws of the State. As such, the Department is responsible for enforcing certain aspects of the New York State Returnable Container Act (Act), also known as the “Bottle Bill.” Enacted in June 1982, and amended several times thereafter, the Act requires a 5 cent deposit on certain beverage containers¹ sold in the State to incentivize their collection, recycling, and reuse across the State, thereby reducing litter and mitigating the threat that discarded beverage containers pose to the health and safety of citizens and the environment. The Act’s provisions are established in Article 27 of the Environmental Conservation Law (Law).

Essentially, bottle bills create a privately funded collection infrastructure for beverage containers, and makes producers and consumers responsible for container waste. Beverage bottlers, distributors, dealers, or agents that register with the Department as “deposit initiators” serve as the catalyst for the bottle deposit process. Generally, the cycle originates and ends with the deposit initiators, as they collect deposits for the cans/bottles they sell and then refund deposits on the cans/bottles that are returned for recycling, as shown in the infographic on page 6. Revenue is realized in the form of deposits that go unredeemed, 80 percent of which goes to the State and the remaining 20 percent goes to the deposit initiator.

All bottle deposits that deposit initiators receive at the initial sale/distribution of beverages are placed in an interest-bearing refund value account (bank account), which deposit initiators are required to establish for the sole purpose of refunding deposits. Deposit initiators must keep track of all deposits collected and submit quarterly reports to the Department. These reports are to include basic information such as deposit amounts to, and withdrawals from, the bank account during the quarter and the final account balance at the close of the quarter. The Department’s Business Tax Unit, which is responsible for processing the deposit initiator quarterly reports, uses the data to calculate the State’s share of unclaimed funds that each deposit initiator must remit to the Department.

The Law authorizes the Department to impose penalties for deposit initiators that fail to register with the Department as a deposit initiator or fail to report to the Department on a quarterly basis. Penalties are up to \$1,000 for each quarter the failure occurs and an additional \$1,000 for each quarter the failure continues, unless the deposit initiator can establish that the failure was due to reasonable cause and not negligence or willful neglect. For reports filed late, a penalty of 5 percent on the amount owed is generated and another 5 percent must be added each month or fraction of a month until the report is received, not to exceed 25 percent in total. The Business Tax Unit is responsible for assessing the appropriate penalties.

¹ The Act defines “beverage container” as an individual, separate, sealed glass, metal, aluminum, steel, or plastic bottle, can, or jar used for containing less than one gallon or 3.78 liters of carbonated soft drinks, water, beer, other malt beverages, and wine coolers.

Monies collected by the Department as part of the unclaimed bottle deposit program are deposited into the General Fund. As of 2009, State officials projected the new requirements for unclaimed bottle deposits would generate at least \$115 million annually. The Department collected \$109.5 million and \$102.7 million in unclaimed bottle deposits in State fiscal years 2015 and 2016, respectively.



Audit Findings and Recommendations

Our tests show the Department deposited all funds received into the General Fund as required by statute. However, we identified weaknesses in the Department's monitoring of deposit initiator reporting and enforcement for initiator non-compliance with the Law.

Deposits to the General Fund

We traced 57 initiator payments totaling over \$1 million during six months of our audit period to bank reconciliations by the Office of the State Comptroller (OSC), and found all deposits were properly recorded by the Department. Additionally, we found that the Department remitted collections from beverage initiators to OSC in a timely manner.

Monitoring of Deposit Initiator Reporting

We analyzed quarterly reports submitted by deposit initiators during our audit scope period and compared them to a Department listing of all deposit initiators. The Department listing shows a total of 515 registered deposit initiators, including 356 active and 159 inactive. Of the 356 deposit initiators listed as active, 39 (11 percent) did not file a return for any quarter during our audit scope period and eight (2 percent) were missing one or more quarterly returns. However, the Department did not issue penalties to deposit initiators that failed to file quarterly reports and took little action to improve deposit initiator compliance. Although the Department sends a notice of deficiency to deposit initiators who fail to file their quarterly report, no further action is taken.

Only those entities that are defined as deposit initiators in the Law should be registered as such, and should submit quarterly reports to the Department. However, we found deposit initiators listed as active that do not file quarterly reports, and other entities reported collecting no deposits yet distributed redemptions. These instances of potential improper reporting indicate the need for improved monitoring and enforcement of deposit initiators. Department officials stated they are in the process of developing a system to identify and generate penalties for non-filers.

Penalties for Late Filing

Our analysis of the timeliness of deposit initiators' quarterly report submissions for the period April 2014 through January 2017 identified 539 reports (18 percent) that were late. We found that the Department imposed penalties in some, but not all, cases of late reporting.

Imposition of Penalties

We compared the late filings from the quarterly report data with the Department's data on penalties imposed, and found 301 late filings were not assessed penalties per the Department's penalty listing. Our analysis of a judgmental sample of 20 of the 301 found nine (45 percent)

lacked a reasonable cause for not assessing a penalty. Department officials stated this was an oversight and they will be issuing penalties and appropriate interest for the nine late filings.

The Department's procedures for imposing penalties include two systems: one to generate a listing of late report filers and a second in which staff manually generate a bill identifying the appropriate penalty and interest for each initiator indicated on the report. The manual nature of the process without a secondary review increases the risk that errors can occur and go undetected. During our audit, the Department provided documentation that it implemented new procedures for a secondary review over the processing of fines to ensure appropriate penalties are imposed for all violations. In addition, the Department officials told us that they are working to automate the penalty process to avoid the risk involved with the current manual process.

Verification of Quarterly Reports

Our analysis of the deposit initiator quarterly report data identified multiple indications of material errors and/or the potential for fraudulent reporting. For example:

- Some reports show collections and redemptions that are not in 5 cent increments.
- Some initiators report bank account service charges that are significantly higher than those reported by other initiators. The service charges are significant because they reduce the amount that the initiator is required to remit to the Department. For example, one initiator reported no deposits collected or distributed during four quarters, but claimed over \$500 in service charges each quarter. Our analysis of a sample of 82 of 612 quarterly reports with relatively high service charges showed service charges for 60 were \$100 or less, eight were from \$100 to \$500, eight were from \$500 to \$1,000, and six exceeded \$1,000.
- Some initiators reported the same redemption percentage for each quarterly filing during our audit scope period, which could indicate the initiator is not reporting the actual amount of deposits collected and redeemed.
- Some initiators are entitled to a refund per their quarterly reports because the deposits distributed and service charges result in a negative ending balance in their bank account. We identified 525 quarterly reports that were eligible for refunds. However, only 15 percent of initiators actually requested the refund. Not claiming a refund may suggest that some refunds are too small for the initiator to bother filing the required documents. For example, 351 of the potential refunds were \$50 or less. However, 142 would have exceeded \$500, and 63 would have exceeded \$20,000. The larger amounts may suggest that the initiator is unwilling to submit the required documents, including invoices of deposits received, refunds paid out, and bank statements. Such documents could potentially show that the amounts reported for deposits distributed or service charges were not supported, or that the initiator is not using the bank account only for bottle deposit activity as required.

During the period April 2014 through January 2017, 79 refunds were requested, of which 70 were approved. Our analysis of the Department's data on claimed refunds and the supporting documentation for a sample of three refunds showed that the documents either reasonably supported the refund or the refund request was denied. With the exception of verifying refunds,

the Department does not have procedures in place to verify the amounts reported or flag questionable reports for further investigation. Instead, the Business Tax Unit accepts the numbers reported by initiators at face value and processes them. The Business Tax Unit stated that any additional investigative work would fall under the Department's audit function. The Department's Transaction Desk Audit Bureau (TDAB) told us it has worked on refunds for unclaimed bottle deposit filings, but has not worked on the accuracy of initiator quarterly reports and did not plan to in the future.

Department officials told us they have begun to develop procedures to identify questionable returns. To aid in their review, the Department plans to require deposit initiators to submit supporting documentation with their quarterly filings, including weekly bank account balances and bank statements. Further, the Department has selected several deposit initiators to be audited by the TDAB.

Recommendations

1. Assess penalties on initiators that fail to file quarterly reports.
2. Implement steps to improve monitoring of deposit initiator reporting, including those that are registered but do not file quarterly reports and those that report no deposit collections but report distributing redemptions.
3. Take corrective action to improve the penalty process, including automating the penalty assessment process and implementing procedures to ensure penalties are assessed for all deposit initiators that file late reports.
4. This recommendation has been deleted.
5. This recommendation has been deleted.
6. Review the red flags that we identified in our report and take appropriate corrective action, such as requesting supporting documentation or conducting investigations.
7. Require deposit initiators to submit supporting documentation with their quarterly reports to support their reported amounts.

Audit Scope, Objectives, and Methodology

The objectives of our performance audit were to determine if the Department is enforcing registration and reporting requirements for deposit initiators, and collecting and depositing the required unclaimed bottle funds into the General Fund. Our audit covered the period April 1, 2014 to February 6, 2017.

To accomplish our audit objectives, we reviewed relevant laws, regulations, and the Department's

policies related to the unclaimed bottle deposit program. We also became familiar with and assessed the Department's internal controls as they relate to deposit initiator reporting. We met with Department officials to gain an understanding of the initiator reporting process. We also met with Department of Environmental Conservation officials to gain an understanding of their role related to the Act.

We also analyzed the deposit initiator quarterly report data from April 2014 to January 2017 and the Department's penalty data for the same period. Specifically, we analyzed the data for trends related to reported numbers and reported redemption percentages. We performed timeliness calculations to determine which initiators filed late and the extent to which reports were overdue. We selected a judgmental sample of 20 of 301 late quarterly report filings to determine why penalties were not assessed. We selected quarterly reports that were late to varying degrees, as defined by us, including significantly late, moderately late, and minimally late. We also selected a sample of 82 of 612 quarterly reports with reported service charges to assess the reasonableness of the service charges in comparison to the bank account balance. We judgmentally selected the 82 reports that had relatively high service charges of 10 percent or more of the total bank account balance. Further, we analyzed the Department's refund data and reviewed associated supporting documentation for three of 70 approved refunds for completeness. We judgmentally selected the three refunds because they were for low dollar amounts, and the initiators reported collections and redemptions that were not in 5 cent increments. Lastly, we manually compared a judgmental sample of 57 of the 2,935 quarterly reports for the period April 2014 through January 2017 with monthly OSC bank reconciliations to check for completeness. We selected six months with lower transaction volumes (July and November of each of the three years in our period) that were easier to trace to the bank reconciliations. We traced all 57 initiator payments to the OSC bank reconciliations.

We conducted our performance audit 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 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.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions, and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating threats to organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority under Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

A draft copy of this report was provided to Department officials for their review and formal comment. Their comments were considered in preparing this final report and are attached in their entirety at the end, along with our State Comptroller's Comments, which address some of their specific statements. While the Department took exception with some of our findings and recommendations, officials generally indicated that they have already begun or intend to implement our recommendations.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Department of Taxation and Finance shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and if the recommendations were not implemented, the reasons why.

Contributors to This Report

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Vision

A team of accountability experts respected for providing information that decision makers value.

Mission

To improve government operations by conducting independent audits, reviews, and evaluations of New York State and New York City taxpayer-financed programs.

Agency Comments



**OFFICE OF PROCESSING AND
TAXPAYER SERVICES**

EDWARD CHASZCZEWSKI
Deputy Commissioner

November 10, 2017

Mr. Stephen Goss
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street
Albany, New York 12236

Re: Report 2016-S-96 - Controls Over Unclaimed Bottle Deposits

Dear Mr. Goss:

The Office of the State Comptroller (OSC) examined the Department of Taxation and Finance (Department) Controls Over Unclaimed Bottle Deposits for the audit period spanning April 1, 2014 through February 6, 2017. This letter responds to the Draft Report summarizing the OSC findings of this audit.

Recommendation 1: Assess penalties on initiators that fail to file quarterly reports.

Recommendation 2: Implement steps to improve monitoring of deposit initiator reporting, including those that are registered but do not file quarterly reports and those that report no deposit collections but report distributing redemptions.

Department Response:

The Department is in the midst of a multi-year multi-tax IT modernization project. Key elements of this project include identifying and quantifying automated assessment conditions, such as late filing of returns, as well as systematic assessment generation. As part of this project, the Department is pursuing modification of our web file application to add reconciliation functionality to the quarterly reporting by deposit initiators. The Department is also in the process of automating its delinquency notices and bills, which we anticipate will be in place before the end of 2017.

Further, the Department's Audit Division has taken steps to develop procedures for providing routine review of return filings, investigating anomalies and identifying optimal candidates for review.

W A Harriman Campus Albany NY 12227 | www.tax.ny.gov

~ 2 ~

Recommendation 3: Take corrective action to improve the penalty process, including automating the penalty assessment process and implementing procedures to ensure the penalties are assessed for all deposit initiators that file late reports.

Department Response:

During this audit period, a total of 3,417 beverage container returns were received and processed. Of the 3,417 returns filed, 3,047 (89.2%) were timely filed with full payment generating \$320,437,024 in revenue. Only 367 (10.7%) of the return filings were identified as being late filed, underpaid or had some other type of assessable condition. During this period, 358 assessments were issued totaling \$4,336,168.64 in tax, penalties, and interest.

During the OSC audit, nine returns were identified as having assessable conditions that were not assessed. These assessments were subsequently issued for a total of \$18,413.93 tax, penalty and interest. These nine unassessed conditions represent 0.3% of the total return filings.

The Business Tax Bureau has implemented a second level review process of all returns that are identified as having an assessable condition to ensure that penalty assessments are timely issued when appropriate. Additionally, any returns identified as not having penalty assessments issued have been billed.

*
Comment
1

Recommendation 4: Implement additional steps to collect on delinquent initiator accounts subsequent to the initial notice and prior to referral to the Collections Unit.

Department Response:

The Department's Business Tax Bureau is responsible for generating assessments against deposit initiators; follow-up by that unit is not appropriate while the taxpayer has the option to exercise administrative rights to formally protest an assessment. Once assessments are fixed and final, any open balances are addressed by the Department's Civil Enforcement Division using appropriate collection techniques.

*
Comment
2

Recommendation 5: Implement a process to share collections information from the Collections Unit with the Business Tax Unit and update Business Tax unit records to reflect such collections.

Department Response:

The Department uses a multi-system approach for administering and collecting taxes, including its Case and Resource Tracking System (CARTS). The CARTS system is utilized for the Department's billing and collection functions and serves as the system of record for return and audit based assessments. All payments on these assessments, whether voluntary or received through enforcement actions, are accounted for in the CARTS system, which then adjusts the balance due on any outstanding assessment. The CARTS system is used by the Office of Processing Services, the Audit Division, Contact Center Division and the Civil Enforcement Division.

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Comment
2

Recommendation 6: Review the red flags that we identified in our report and take appropriate corrective action, such as requesting supporting documentation or conducting investigations.

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Department Response:

The Department will review the red flags identified in this report and will take corrective action as appropriate.

Recommendation 7: Require deposit initiators to submit supporting documentation with their quarterly reports to support their reported amounts.

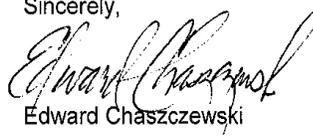
Department Response:

Generally, every deposit initiator must maintain accounts, records or documents related to the sale of beverage containers in New York State for a period of three years. Such accounts, records, or documents must be provided to the Department upon request. As is the case with the majority of our audit programs, supporting documentation is requested on an as needed basis.

The Department is developing revised technical guidance to reinforce record keeping and supporting documentation requirements necessary to validate refund claims.

The Department would like to thank the OSC auditors for their professionalism during the conduct of this audit.

Sincerely,



Edward Chaszczewski

State Comptroller's Comments

1. The Department states that it has taken action to ensure penalty assessments are issued timely, and it has also billed returns that had not been previously assessed penalties. The Department also presents statistics that differ from, and do not specifically address, our findings. The Department's statistics are for an undisclosed time period and commingle the number of quarterly reports that were late with others that were underpaid or had another assessable condition. For example, the Department states that only 367 were late, were underpaid, or had another assessable problem. However, we found 539 quarterly reports were late, which does not include those that were underpaid or had another assessable condition. Additionally, the Department states that nine returns were identified as having assessable conditions that were not assessed. However, we reported that the nine were from our sample of only 20 out of the 301 that were not assessed penalties. The Department does not address the remaining 281 that were late but not assessed penalties.
2. We have revised the report to reflect information provided in the Department's response.