PERFORMANCE AUDIT

DEPARTMENT OF REVENUE

ADMINISTRATIVE SERVICES AND TAXPAYER SUPPORT DIVISION

Report to the Arizona Legislature
By the Auditor General
December 1995
Report #95-16

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December 11, 1994

Members of the Arizona Legislature

The Honorable Fife Symington, Governor

Mr. Harold Scott, Director
Arizona Department of Revenue

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Arizona Department of Revenue - Administrative Services and Taxpayer Support Divisions. This report is in response to a May 5, 1993, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review set forth in A.R.S. §§ 41-295 through 41-2957.

This is the second in a series of reports to be issued on the Department of Revenue (DOR). The report recognizes the significant improvements made in the Department's Taxpayer Assistance Division since our 1988 audit, but also addresses DOR's need for additional improvements in several areas. DOR needs to expand the use of electronic funds transfer to allow businesses to remit their transaction privilege tax payments electronically. In addition, the Legislature should consider allowing DOR to assess a fee to cities, towns, and counties to cover the costs of collecting and distributing their tax monies. DOR can reduce its high busy signal rate for taxpayer telephone calls by adopting an automated response system to answer common taxpayer questions. By using common locator techniques, DOR can return more unclaimed property to its rightful owners. Finally, DOR needs to improve enforcement of bingo statutes or move the function to an agency that is more enforcement oriented.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on December 12, 1995.

Sincerely,

Douglas R. Norton

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Auditor General

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SUMMARY

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Revenue (DOR), Administrative Services and Taxpayer Support Divisions, pursuant to a May 5, 1993, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review set forth in Arizona Revised Statutes (A.R.S.) §§41-2951 through 41-2957. This audit is the second of four audits of the Department.

Our analysis of the Taxpayer Support Division included a follow-up to our 1988 report, which pointed out deficiencies in the Division's Taxpayer Information and Assistance Unit (TIA). Specifically, our 1988 report found that TIA needed to improve the time it takes to resolve taxpayer inquiries, improve productivity, reduce employee turnover, and improve staff training. During the course of our current audit, we found significant improvements in all of these areas. For example, our 1988 report found that it took TIA an average of approximately 125 days to respond to taxpayer inquiries. In fiscal year 1994-95, TIA took an average of 16 days to respond to taxpayer inquiries.

Expanding Electronic Funds Transfer Would Increase Revenue and Improve Tax Processing Efficiency (See pages 5 through 8)

DOR can increase revenue and improve tax processing efficiency by expanding the use of electronic funds transfer (EFT). EFT provides significant benefits to both DOR and taxpayers, including less manual document processing, fewer processing and taxpayer errors, increased interest earned for the State, and payment verification for taxpayers. Statutes permit DOR to implement EFT for any taxpayer who owes $20,000 or more for any tax DOR collects (except individual income taxpayers). However, DOR only requires taxpayers owing $50,000 or more in annual corporate estimated income and $50,000 in quarterly withholding payments to use EFT. Although some major taxpayers have requested that DOR begin accepting sales tax payments via EFT, as it does for other taxes, DOR currently does not use EFT to collect sales tax.

Our analysis shows that using EFT for the collection of sales tax, and requiring all taxpayers who owe $20,000 or more per filing period in annual corporate estimated income and in quarterly withholding payments to use EFT, has the potential to generate over $1.2 million annually in increased interest earned. It will also reduce the number of documents DOR must process by approximately 170,000 each year. Expanding the use of EFT should not overburden taxpayers, since taxpayers need only complete a toll-free telephone call to initiate their electronic payment. To expand the EFT program to include sales tax, the Legislature should consider amending A.R.S. §42-1322 to establish a specific filing date for payments remitted using EFT. Currently taxes are due on the twentieth

day of the month. However, to account for mailing deadlines, statutes also allow two later dates for remitting sales tax.

DOR Should Recover Costs for Collecting and Distributing Taxes for Local Jurisdictions (See pages 9 through 12)

DOR should charge an administrative fee for collecting cities' and counties' taxes. Although the largest cities operate their own sales tax programs, DOR provides numerous free services collecting and distributing taxes — including taxpayer licensing, document processing, and collection and auditing services — for 73 cities and towns. Although DOR has never calculated the actual cost of providing these services for local jurisdictions, studies conducted by other states suggest that these costs may be from $2 million to $3 million annually. Most states that collect and administer taxes for cities, towns, and counties charge an administrative fee of less than 1 percent of taxes collected. Based on sales tax collections for fiscal year 1993-94, a 1 percent fee in Arizona would generate approximately $2.8 million a year.

Most cities would probably continue to rely on DOR to collect and administer local sales taxes if a fee was implemented. Since 51 of 73 cities for which DOR currently collects taxes would pay an administrative fee of less than $15,000 annually, it would be difficult for most cities to provide their own services for less than DOR would charge. Cities with large tax amounts, however, may consider adopting their own programs to collect and administer local sales taxes. In fact, one small city that started collecting its own sales tax spent approximately $40,000 during fiscal year 1992-93 for various necessary expenses; however, under a 1 percent fee system, it would have paid DOR approximately $20,000 for these same services.

Counties, unlike cities, are required by statute to use DOR's services. However, other states also charge counties a fee for these services. The Legislature should consider amending A.R.S. §42-1451 to enable DOR to charge an administrative fee.

Poor Phone Access Limits Taxpayers' Ability to Obtain Information and Assistance (See pages 13 through 16)

DOR needs to improve telephone access to the Taxpayer Information and Assistance Unit (TIA). Busy signal studies commissioned by TIA indicate that more than half of callers seeking assistance are unable to get through to TIA. DOR can satisfy nearly 75 percent of this unmet demand, without adding staff, by installing an interactive voice response system (IVR) and by expanding the capacity of its tax tape system. IVR systems

are already used extensively in the private sector. For example, banks have implemented IVR systems to allow their customers to use phones to access personal account information. IVR could be used similarly at DOR, allowing taxpayers to access information on the status of refunds, billings, and tax liability. Several other states and the Internal Revenue Service already use this technology, and report dramatic results and high taxpayer satisfaction. DOR should also expand the capacity of the current tax tape system to allow taxpayers telephone access to more detailed prerecorded information.

These measures are a more cost-efficient way to satisfy taxpayer demand than adding staff. Implementing an IVR system and expanding tax tapes would result in a one-time cost of approximately $80,000, as opposed to an annual cost of about $250,000 for additional staff.

DOR Needs to Improve Its Unclaimed Property Program (See pages 17 through 23)

DOR needs to develop a more aggressive unclaimed property program to collect abandoned property and, where possible, return it to rightful owners. Unclaimed property typically includes inactive bank accounts, stocks, bonds, uncashed checks, and the contents of safe deposit boxes. While owners never lose their rights to the property, the State uses unclaimed property to fund various state programs, including the Unclaimed Property Unit.

DOR needs to do more to return property to rightful owners. DOR currently relies on advertising and computer matches of addresses to identify property owners. In addition, instead of advertising "well known" accounts, DOR attempts to contact them directly. However, some of these accounts had yet to be contacted many months after DOR had obtained the money. For example, DOR did not return a substantial amount of unclaimed property belonging to the San Xavier Mission del Bac. Using the same techniques DOR uses to find individuals who owe money to the State, our analysis shows that DOR could have returned an additional $800,000 in unclaimed property to owners in 1995 alone. DOR could fund additional locator resources by using savings from streamlining advertising or requesting use of additional unclaimed property monies.

In addition, experiences here and in other states indicate that Arizona could recover as much as $25 million more in unclaimed property by 1) revising the statutes to reduce holding periods from five to three years for most types of property; and, 2) improving DOR's unclaimed property audit program. Property owners would benefit from shorter holding periods because DOR would have more recent, and therefore more useful, information on rightful owners.

DOR Needs to Improve Its Enforcement of Bingo Statutes (See pages 25 through 28)

DOR is not adequately enforcing bingo statutes. Bingo is a significant gaming activity in Arizona, with approximately $50 million in gross receipts in fiscal year 1994-95. DOR has not ensured that criminal complaints related to bingo operations, such as those involving theft, embezzlement, and misappropriation of bingo funds, are investigated. Although DOR has had an agreement with the Department of Public Safety (DPS) since 1989 to investigate bingo complaints, only 15 of 124 complaints have been investigated. For example, one complaint that was not investigated involved a Phoenix charity's bingo manager allegedly engaging in felonious activity, including misappropriation of funds for personal use and filing false monthly bingo reports to DOR. According to DPS, violations of bingo statutes are seldom investigated due to resource limitations and because these cases often involve less serious criminal activity than other cases they routinely investigate. To improve enforcement, DOR should either resume their own efforts to fully investigate complaints or provide DPS with additional resources to cover the cost of investigating complaints. As another option, the Legislature could consider transferring the Bingo Enforcement Unit to a more enforcement-oriented agency such as the State Gaming Agency.

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INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Revenue (DOR), Administrative Services and Taxpayer Support Divisions, pursuant to a May 5, 1993, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review set forth in Arizona Revised Statutes (A.R.S.) §§41-2951 through 41-2957. This audit is the second of four audits of the Department.

The purpose of the Arizona Department of Revenue is *"to efficiently and fairly administer and collect the taxes levied by this state, to value and assess property subject to state property tax assessment and to determine and set assessing standards and practices for use by local assessing officials and personnel."*

Organization and Staffing

DOR is organized into five divisions, each managed by an assistant director: Administrative Services, Data Management, Property Valuation and Equalization, Compliance, and Taxpayer Support. This audit focused on the Administrative Services and Taxpayer Support Divisions. These two divisions employed approximately 20 percent of DOR's 1,245 full-time equivalent (FTE) personnel approved for fiscal year 1994-95. Most of the Division's staff are located at DOR's main office in Phoenix; however, staff are also located in field offices around the State.

Division Responsibilities

DOR's Administrative Services and Taxpayer Support Divisions oversee a number of programs to help ensure that taxes are collected in an efficient manner. Some examples of each division's responsibilities include:

- **Administrative Services** — The Administrative Services Division is responsible for overseeing records management, facilities management, training, purchasing, bingo, hearings, and the Comptroller's Office.

- **Taxpayer Support** — The Taxpayer Support Division is responsible for taxpayer information and assistance, accounts receivable, licensing and registration, penalty review, community activities and publications, central information services, and taxation systems support.

1988 Report Follow-up and Update

As part of our current audit, we reviewed the findings and recommendations made in our 1988 performance audit of the DOR Taxpayer Services functions (Auditor General report 88-6). Our follow-up work indicates DOR has taken steps to address most of our original concerns.

- **1988 Finding/Recommendation:** In our 1988 report we indicate that Taxpayer Services had made significant operational improvements since our 1985 report. Nevertheless, billing inquiries were still not resolved in a timely manner and the Unit was suffering from a large backlog of taxpayer inquiries. In fact, our analysis revealed that in 1987 it took the Unit an average of approximately 125 days to respond to taxpayer inquiries. In addition, the percentage of taxpayer cases older than 8 weeks exceeded 50 percent during 8 of the 12 months examined. We recommended that DOR improve productivity and reduce response time to taxpayer inquiries.

  Follow-up: An analysis of all 34,000 taxpayer inquiry cases opened during fiscal year 1994-95 shows that it is currently taking TIA an average of 16 days to process a case and respond to a taxpayer. This turnaround time compares favorably with states such as Virginia, which takes an average of 70 days to respond to a taxpayer inquiry; or Massachusetts, which reports 6 weeks as an average turnaround time. Meanwhile, TIA has also been successful in reducing its case backlog. For example, our analysis of TIA's case inventory during fiscal year 1994-95 shows that at no point did cases older than 8 weeks exceed 12 percent of total inventory. Overall, 73 percent of cases during fiscal year 1994-95 were between 1 and 4 weeks old, 20 percent were between 5 and 8 weeks old, and only 7 percent of cases were older than 8 eight weeks.

- **1988 Finding/Recommendation:** In 1988, we reported that TIA was suffering from a high turnover rate among its taxpayer service technicians (TST). This turnover rate, noted as a contributing factor to the Unit's slow turnaround time mentioned above, was determined to be 131 percent. In fact, the report pointed out that TSTs only stayed with the Division an average of six months. Our audit recommended that DOR take steps to reduce turnover through more effective management and improved training for new hires.

  Follow-up: Since 1988, DOR has successfully reduced the TST turnover rate from 131 percent to 16 percent. In addition, average tenure with the Unit has increased from 6 months to 2.3 years. Meanwhile, management has actively matched employee training needs with courses developed by DOR's Training Section. Management also assesses each employee's training needs annually and courses are added as needed.

- **1988 Finding/Recommendation:** In 1988, we reported that DOR had decided not to conduct fingerprint checks of bingo licensees as recommended in our 1985 report. We also noted that placement of the Bingo Section, both in terms of where it should be located within DOR and whether it should be moved out of DOR, remained unresolved issues. For example, from 1985 to 1988, the Bingo Section was moved four times within DOR's organizational structure.

  Follow-Up: DOR still does not utilize fingerprinting as a tool for conducting background investigations of licensed bingo applicants. Moreover, since 1988 the Bingo Enforcement Unit has moved within DOR's organizational structure a total of eight times. Currently, the Bingo Enforcement Unit is part of the Administrative Services Division.

Scope and Methodology

Our audit report of these two divisions focuses on five major programs: electronic funds transfer (EFT), tax collection for local jurisdictions, taxpayer information and assistance, unclaimed property, and bingo enforcement.

We utilized a variety of methods in our analysis to determine turnaround time and case inventory for taxpayer inquiries, busy signal rates, and methods to locate owners of unclaimed property. For taxpayer inquiries, we reviewed the entire population of taxpayer inquiry cases opened between July 1, 1994, to June 30, 1995, and, using DOR's computer tracking system, measured the time from case receipt to taxpayer notification. DOR also provided fiscal year 1994-95 reports that track inventory age.

To evaluate phone access, we analyzed U.S. West Communications busy signal studies commissioned by DOR. The studies, which generally focused on 2 of TIA's 5 phone lines at a time for 10 one-week periods, revealed the number of attempts to access TIA and the number of busy signals encountered by taxpayers. Using a methodology suggested by both U.S. West Communications and DOR's Telecommunications Specialist, we determined busy signal rates. We then used the busy signal rate to estimate unmet demand.[1]

Finally, we selected a statistically significant sample of 150 owners of unclaimed property accounts worth $250 or more. The accounts sampled were worth a total of $755,619. To locate owners of unclaimed property we searched computerized national and regional telephone directories in public libraries for owners' current telephone numbers. Owners not located through phone directories were referred to DOR's Skip Trace Unit to obtain individual income and business tax records, and Motor Vehicle Division and Department of Economic Security information. Credit bureau reports were obtained for only those owners not located through other channels. With the exception

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[1] Although the busy signal studies indicate there is a significant unmet demand, the actual size of it cannot be determined with available data.

of staff time, all activities were free except the credit reports, which cost no more than $1.40 each.

Our report presents findings and recommendations in five areas addressed by our audits of the Administrative Services and Taxpayer Support Divisions. The findings and recommendations in this report address:

- The need to establish an EFT program for collection of sales tax and require taxpayers paying more than $20,000 per filing period in corporate estimated income and withholding taxes to remit these taxes using EFT.
- The need to recover costs for administering the collection and distribution of taxes for local jurisdictions.
- The need to improve taxpayer telephone access to information and assistance.
- The need to develop a more aggressive unclaimed property program to both collect abandoned property and return more of it to rightful owners.
- The need to improve enforcement of bingo statutes.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the Director and staff of the Department of Revenue for their cooperation and assistance throughout the audit.

FINDING I

EXPANDING ELECTRONIC FUNDS TRANSFER WOULD INCREASE REVENUE AND IMPROVE TAX PROCESSING EFFICIENCY

DOR can increase revenue by over $1.2 million annually and improve tax processing efficiency by expanding the use of electronic funds transfer (EFT). EFT provides significant benefits to both DOR and taxpayers.[1] Implementing an EFT program for sales tax and requiring more taxpayers to use EFT for corporate estimated income and withholding taxes would enhance revenue and improve tax processing efficiency.[2]

Since 1992, state statutes have required some taxpayers to pay taxes using EFT. State statutes permit DOR to implement EFT for any taxpayer who owes $20,000 or more for any tax DOR collects except individual income taxpayers. Currently, DOR only requires taxpayers owing $50,000 or more in annual corporate estimated income payments and quarterly withholding payments to use EFT. Other taxpayers who wish to voluntarily submit these taxes using EFT may do so. While at least 20 states use or plan to use EFT to collect sales tax, DOR currently has no program to collect sales tax via EFT.

EFT Beneficial for Taxpayers and DOR

Thus far, DOR's experience using EFT shows it is beneficial to both DOR and taxpayers. For example, because EFT allows information to be sent electronically for corporate estimated income and withholding taxes, DOR processes approximately 60,000 fewer tax documents. Also, EFT reduces document processing errors since DOR does not have to re-key transmitted data. In addition, experts suggest EFT increases revenue by eliminating mailing and processing delays common in a paper check environment, thereby making funds available to the State more quickly. Finally, DOR contracts with a private firm to operate its EFT program. The cost is relatively inexpensive, approximately 50 cents per transaction, and is borne by the State. EFT also provides numerous benefits for taxpayers, such as payment verification, reduced fraud, and ease

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(1) EFT refers to the process of remitting payment information electronically. EFT is a generic term applied to any of several payment methods from one party to another through a series of instructions and messages communicated electronically among financial institutions, initiated through an electronic terminal, telephone, computer, or magnetic tape.

(2) Arizona does not impose a "true" sales tax, but a transaction privilege tax. The public commonly refers to the transaction privilege tax as a sales tax.

of use. According to the Federation of Tax Administrators, EFT transactions are particularly easy to perform, since taxpayers need only complete a toll-free telephone call to initiate their electronic payment.

DOR Should Expand Its EFT Program to Include Sales Tax

Although DOR uses EFT to collect corporate estimated and withholding taxes, it does not use EFT to collect sales tax. Using EFT to collect sales tax has the potential to increase interest earned by as much as $1.2 million annually. To expand the EFT program to include sales tax, the Legislature should consider amending A.R.S. §42-1322 to establish a specific filing date for EFT payments.

Collecting sales tax with EFT would increase revenue – As illustrated in Table 1, DOR could gain substantial revenue by taking advantage of interest it is currently losing in the slower paper check environment. For example, requiring taxpayers who owe $1,000,000 or more annually in sales tax to use EFT affects only 358 of the largest taxpayers, but could potentially result in about $900,000 in additional annual interest revenue because funds are available sooner.

Table 1

Potential Revenue Gained Annually Using EFT for Sales Tax

Annual Sales Tax Remittances	Number of Taxpayers Affected	Sales Tax Submitted by These Taxpayers (Fiscal Year 1994)	Potential Interest Earned [a]
$1,000,000 and Over	358	$1,406,588,763	$ 914,380
$500,000 to $999,999	374	259,731,896	168,844
$240,00 to $499,999	626	213,178,602	138,581
Totals	1,358	$1,879,499,261	$1,221,805

[a] Potential interest earned was calculated using methodology similar to a DOR analysis done in 1992. We determined annual sales tax remittances submitted by taxpayers in fiscal year 1994. We then calculated potential interest earned by eliminating typical postal and bank processing delays by using EFT. Calculations assume a short-term interest rate of 5.75 percent, as provided by the State Treasurer's Office, and EFT payments due on the 20th day of each month.

Source: Auditor General staff analysis of fiscal year 1994 sales tax information provided by DOR.

To ensure successful implementation, DOR could develop a pilot program using EFT to collect sales tax from those filing large amounts of tax. Once the pilot program has been successful, DOR should require all taxpayers who owe $20,000 or more per filing period to use EFT for sales tax. Such an action would only affect approximately 1 percent of all the taxpayers who pay sales tax. However, in fiscal year 1993-94 these taxpayers submitted 65 percent of the sales tax collected by DOR.

Although some taxpayers who pay large amounts of sales tax have requested DOR accept sales tax payments using EFT, DOR has not done so because EFT cannot currently transmit all the information contained on sales tax forms. Expanding the use of EFT to sales tax will require a significant amount of computer programming. Using current resources, DOR estimates it may take one to two years to accomplish the programming needed and to initiate a pilot test of the program. Another filing option may be for DOR to use Electronic Data Interchange (EDI). This is a new technology in which the taxpayer electronically transmits both the tax payment and the tax information through a private vendor. Florida and South Carolina have recently begun using EDI for sales tax remittances.

Statutory change would be needed — A.R.S. §42-1322 would need to be changed to require taxpayers to file their sales tax payments on one standard date each month. Currently, sales tax is due on the twentieth, twenty-fifth, or second-to-the-last business day of each month. These different dates are provided to account for mailing deadlines. There is currently no provision for an EFT deadline for sales tax. Many states, including Florida, have sales tax due by one date each month. If the statute is not revised, EFT taxpayers may utilize later deadlines that are intended for filing by mail, thus costing the State interest it might have earned had sales tax been remitted earlier.

DOR Should Require More Taxpayers to Participate in Its Current EFT Program

As noted previously, Arizona statutes allow DOR to require all taxpayers who owe $20,000 or more to use EFT. However, DOR has implemented EFT gradually. Beginning in January 1993, DOR required taxpayers owing $100,000 for corporate estimated income and withholding taxes during the prior year to use EFT. In January 1994, DOR lowered the requirement to the current level of $50,000. Further lowering the requirement to $20,000 per filing period would be consistent with the requirements of other states and the federal government. The Federation of Tax Administrators reported that most states with EFT programs generally require taxpayers with an average liability of $20,000 per filing period to file taxes using EFT. Also, because of requirements mandated in the North American Free Trade Agreement Implementation Act (NAFTA), the U.S. Department of the Treasury has developed an electronic tax payment system for taxpayers to report and pay federal depository taxes such as FICA, corporate income, and various federal excise taxes. As of January 1, 1999, all federal

taxpayers with a tax liability of $20,000 or more in calendar year 1997 will be required to file depository payments using EFT.

Extending EFT to include all taxpayers owing $20,000 or more per filing period for corporate estimated income and withholding taxes has the potential to increase interest earned by as much as $120,000 annually and reduce the number of withholding and corporate income documents DOR must process by approximately 150,000 per year.[1]

RECOMMENDATIONS

1. The Legislature should consider amending A.R.S. §42-1322 to establish a specific filing date for EFT payments.

2. To improve tax processing efficiency and increase revenue, DOR should establish an EFT program for sales tax collection.

3. DOR should require taxpayers with a liability in excess of $20,000 per filing period in corporate estimated income and withholding taxes to remit tax payments using EFT.

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[1] Potential interest earned was calculated using methodology similar to that used to determine interest earned by requiring EFT be used for sales tax.

FINDING II

DOR SHOULD RECOVER COSTS FOR COLLECTING AND DISTRIBUTING TAXES FOR LOCAL JURISDICTIONS

DOR should charge an administrative fee to pay for tax collection services it currently provides cities, towns, and counties at no cost. Unlike Arizona, most states charge an administrative fee to recover costs incurred from administering the collection and distribution of taxes for cities, towns, and counties. In fact, a 1989 report issued by the Joint Select Committee on State Revenues and Expenditures noted that charging a fee makes sense economically, so that local residents pay the cost of their own tax systems. Moreover, it appears that most cities and towns contacted would be reluctant to collect and administer the sales tax themselves since the administrative fee would generally be less than the cost of operating their own sales tax collection programs. Officials from other states and national experts agree that an administrative fee should be based on the cost to administer and collect taxes for local jurisdictions.

According to statute, DOR may collect and administer any transaction privilege license tax or use tax imposed by any city, town, or recreation center district. Local jurisdictions enter into intergovernmental agreements if they wish to have DOR administer their local sales tax. For example, DOR currently collects various local taxes such as sales tax for most cities and towns at no charge. In addition, counties imposing general excise, transportation, jail, hotel/motel, and stadium taxes are required, by statute, to have these taxes collected by the State. In fact, as of April 1, 1995, DOR collected taxes for 73 of 86 cities and towns and 14 counties at no charge.[1] Currently, a taxpayer submits to DOR the sales tax on one paper form which includes town, city, county, and state sales tax remittances. DOR processes the tax documents and payments and remits the appropriate amount to cities and towns on a weekly basis and to counties on a monthly basis.

DOR Provides Significant Services at No Charge

DOR provides a variety of free services to cities, towns, and counties that have their taxes collected and administered by DOR. These services include taxpayer licensing, document processing, mailing and postage, accounting services, investigating services, collections, taxpayer audits, taxpayer education, computer programming, and tax

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[1] Cities that collect their own sales tax are Avondale, Chandler, Flagstaff, Glendale, Mesa, Nogales, Patagonia, Peoria, Phoenix, Prescott, Scottsdale, Tempe, and Tucson.

reports generated by DOR for local jurisdictions. Although DOR has never calculated the actual cost of providing these services for local jurisdictions, cost studies conducted in other states have shown that they are significant. For example, an audit of the Utah Tax Commission estimated it cost at least $2.2 million to run its program for 29 counties, and 227 cities and towns, while an official from Minnesota's Department of Revenue estimated it cost about $600,000 a year to run its program for just 5 of its cities.

In addition, Arizona is more generous than most states because it disburses the sales tax weekly to cities and towns rather than monthly. As a result, the State gains little interest revenue. For example, we analyzed sales tax payments collected by DOR for all 73 cities involved, and estimate that the State earned approximately $80,000 in interest revenue during fiscal year 1994-95. However, since DOR makes monthly tax disbursements to counties, the interest gained by the State for collecting and administering county taxes is more significant. We estimate that the State earned approximately $200,000 in interest by collecting tax for the counties during fiscal year 1994-95. Based on the experiences of other states and according to experts, this interest earned is probably not sufficient to cover DOR's costs for collecting and administering taxes for local jurisdictions.

An Administrative Fee Is Common and Cost-Effective

To cover these costs, most states and experts believe an administrative fee should be charged. For most cities, an administrative fee would be less expensive than collecting and administering the sales tax themselves.

Need for cost recovery recognized — The vast majority of states that administer taxes for local jurisdictions charge a fee. According to national experts in sales taxation, 30 states have state-administered local sales tax. Arizona is one of only five states that administers the tax at no charge. Although some states charge an administrative fee of up to 3 percent of collected revenues to cover administration costs, most states typically charge a fee of less than 1 percent. According to national experts, an administrative fee up to 1 percent should be adequate to cover costs of administering the program. If Arizona charged cities, towns, and counties a 1 percent fee, it would have generated approximately $2.8 million during fiscal year 1993-94 to cover services currently offered by DOR for free. Moreover, a 1989 report issued by the Joint Select Committee on State Revenues and Expenditures noted that economically, it makes sense for Arizona to charge local jurisdictions for tax collection so that local residents pay the cost of their own tax systems.

A fee is still cost-effective for cities — For most small and medium-sized cities and towns, an administrative fee is more cost-effective than administering and collecting the sales tax themselves. Our analysis indicates most cities currently in the program would pay much less under a 1 percent fee system than what it would cost to administer and collect their

taxes themselves. We estimate that 50 of 73 cities would pay less than $15,000, and only 9 of 73 cities would pay $50,000 or more annually.

Our survey of ten cities and towns with small and medium sales tax amounts for which DOR currently administers the sales tax found that these cities and towns believe they would be unable to maintain DOR's service level at a cost lower than a 1 percent fee.[1] These cities, especially those with small tax amounts, told us they would be reluctant to collect and administer the sales tax themselves since cities paying a 1 percent fee would generally pay less than cities operating their own sales tax collection programs. For example, one smaller town that started collecting its own sales tax spent approximately $40,000 in fiscal year 1992-93 for various expenses, such as computer software and installation, salary for a clerk position, auditing services, and printing and postage. Under a 1 percent fee system this town would have paid DOR approximately $20,000 for these same services. In contrast, bigger cities with large tax amounts would consider adopting their own programs to collect and administer local sales taxes if DOR implemented an administrative fee. For example, under a 1 percent fee system Yuma would have paid approximately $125,000 during fiscal year 1994-95 for state administration and collection of its local taxes. According to a Yuma finance official, the City would consider implementing its own program to collect the sales tax at that cost. Although some cities with large tax amounts may be able to provide some of the services currently provided by DOR, national experts agree that it is unlikely they could meet the quality of administration currently provided by the State.

While cities and towns have the option of allowing DOR to collect and distribute their sales tax, DOR is required, by statute, to administer county taxes. According to experts in sales taxation, many states mandated to administer sales tax charge counties a fee for this service. Our analysis indicates that if Arizona charged counties a 1 percent fee to cover costs of administering the program, Maricopa County would have been charged approximately $1.4 million while La Paz County would have incurred a fee of approximately $3,700 during fiscal year 1993-94.

Cost Study Needed

DOR needs to conduct a cost study to determine an appropriate fee to charge local jurisdictions for tax collection and administration. This cost study should analyze all units within DOR that perform tasks for local jurisdictions. For example, the cost study would have to consider tax processing, auditing, research and analysis, postage, computer programming, taxpayer education, accounting services, report processing, investigative services, and any other functions performed on behalf of local jurisdictions at no cost. Other states base their administrative fee on cost studies and experts agree that most states charge an amount equal to the cost of administration. For example, several states, including Alabama and Utah, have conducted cost studies to determine how much to charge local

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[1] We contacted the following cities and towns for which DOR currently collects the sales tax: Huachuca City, Miami, Parker, Thatcher, Snowflake, Cottonwood, Bullhead City, Casa Grande, and Yuma.

jurisdictions. Utah, in its cost study, noted that any determination of local sales tax costs has to consider both common and marginal costs.[1]

RECOMMENDATIONS

1. The Legislature should consider amending A.R.S. §42-1451 to allow DOR to charge an administrative fee for collection and administration of local taxes.

2. DOR should determine an administrative fee for collecting and administering local jurisdiction taxes based on a comprehensive cost study.

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[1] Common costs such as forms processing, auditing, and collections are costs that provide a dual benefit to the State and local governments. Marginal costs, such as distributing revenue to local jurisdictions, are costs the State incurs because they are performed only because of the local tax.

FINDING III

POOR PHONE ACCESS LIMITS TAXPAYERS' ABILITY TO OBTAIN INFORMATION AND ASSISTANCE

Although 86 percent of Arizona taxpayer inquiries are directed at DOR via the telephone, studies indicate that more than half of taxpayers' calls may receive busy signals. However, the Department can, for a reasonable cost, use technology to significantly improve the public's access to information and assistance.

Too Many Taxpayer Calls Receive Busy Signals

Despite the importance of telephone contact, many members of the public cannot gain telephone access to information and assistance. In fact, busy signal studies commissioned by DOR and provided by U.S. West during fiscal year 1994-95 found busy signal rates of 57 percent. Nevertheless, DOR could satisfy nearly three quarters of excess telephone demand in a very cost-efficient manner by installing an interactive voice response system (IVR) and by expanding the current tax tapes system.

Taxpayers approach the Taxpayer Information and Assistance Unit (TIA) with their inquiries via telephone, correspondence, and/or a personal visit. Of these three, the most common method of communication is the telephone. In fact, during the last fiscal year, telephone inquiries represented 86 percent of 400,962 Arizona taxpayer inquiries.

Many callers encounter busy signals — Our analysis of telephone access indicates that during the time when taxpayers most need assistance, they are least likely to gain access to TIA. Busy signal studies commissioned by TIA and obtained from U.S. West reveal that over half of taxpayer calls are receiving busy signals. Even after people who make multiple attempts to gain access on a single occasion (redialers), analysis of the busy signal studies indicates that as many as 321,000 callers may not have been able to access telephone assistance during the year.[1] In fact, the vice-president of the Arizona Forum for Improved Taxation, a tax practitioner group, says that poor phone access to TIA is

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[1] We estimated unmet demand by dividing the total number of calls received by TIA during fiscal year 1994-95 (346,237) by the percentage of calls that were received (43 percent) assuming that 57 percent of calls receive busy signals (346,237 ÷ .43 = 805,202 total calls). We then subtracted the total number of calls received by TIA from the total number of calls attempted and discounted the remaining number by 30 percent to account for redialers. (805,202 - 346,237 = 458,965 total calls; 458,965 x .70 = 321,275 total callers.

common knowledge and that the condition actually discourages many taxpayers from even trying to call.

Overall, the studies show that TIA's Income Tax Section experiences high busy signal rates primarily during peak tax season months from January through May. Meanwhile, busy signal rates associated with TIA's Business Tax Section show a more consistent trend throughout the study months. Only TIA's Tucson office appears, based on the studies, not to suffer from a significant busy signal rate.

DOR Should Implement Available Technology to Help Satisfy Demand

Implementing additional technology could address as much as 74 percent of the busy signal problem. By installing an interactive voice response system, we estimate DOR could satisfy 68 percent of excess telephone demand. An additional 6 percent could be addressed by expanding the current Applied Voice Technology system (AVT) or tax tape system. Discussion with other states, as of 1994-95, indicates that these additions alone could satisfy nearly three-quarters of the currently unmet demand for phone access in a very cost-effective manner.

Interactive voice response (IVR) — Our review suggests that the implementation of an IVR system alone could satisfy as much as 68 percent of unmet demand. Designed to provide access to account information via the use of a personal identification number, IVR is already used extensively in the private sector. For example, banks allow their customers to use phones to access personal account information regarding balances, withdrawals, and deposits. Meanwhile, mail catalog companies use IVR to allow their customers to order merchandise over the phone and to verify their account balances. IVR can be used very similarly at DOR. Taxpayers could, using IVR and a touch-tone phone, access various pieces of tax-related information. For example, if a taxpayer was interested in knowing the current status of his or her refund, IVR would search the DOR system for the current status of the return and report it back to the taxpayer. This same application would also be relevant to inquiries such as billings, accrued interest, and tax liability.

Other states, as well as the IRS, are experiencing dramatic effects from their use of IVR. For example, the Phoenix IRS Office was able to use an IVR system to serve approximately 615,000 taxpayers during fiscal year 1994-95, while Massachusetts has been able to reduce seasonal staff by 50 percent and service more than 400,000 taxpayers per year with their IVR system. Illinois, touted by the Federation of Tax Administrators as the nation's technological leader, uses an IVR system to answer approximately 700,000 calls per year. In addition, New York's IVR system answered more than a quarter million inquiries last fiscal year, while Virginia used an IVR system to respond to nearly 140,000 inquiries. Moreover, Minnesota reports that more than 50 percent of taxpayer calls were

handled by their IVR system last year. In fact, of the 12 jurisdictions we contacted, 8 are either using IVR or will be by the first part of 1996.

Our study of inquiry categories and discussion with TIA management indicate that DOR could also expect significant results from the use of IVR. Based on TIA management's identification of inquiry types that could be addressed by this system and our analysis of fiscal year 1994-95 phone inquiries, we found that as many as 220,000 calls could be serviced by IVR. These 220,000 calls equate to 68 percent of the 321,000 callers who receive busy signals.

An IVR vendor recently estimated the total cost of this system to be approximately $74,000.[1] DOR's Data Management Division, while stating that the installation of such a system is feasible, cautioned that internal programming time will be required to make IVR initially functional. Other states that have implemented IVR and an IVR vendor all indicated this time to be approximately 100 to 200 hours, based on their own experiences.

Tax tape expansion — An additional 6 percent of excess demand could be satisfied by the expansion of TIA's Tax Tape System (AVT).[2] AVT, which provides prerecorded information that taxpayers can access through a touch-tone phone, assisted 70,000 taxpayers during fiscal year 1994-95, an increase of 50,000 from the previous year. Although TIA management states that the system is now at capacity, expansion of AVT to include more specific tax form information could allow an additional 20,000 taxpayers to be served by AVT during fiscal year 1995-96. The vendor who originally sold DOR the AVT estimates that it would cost no more than $5,000 to double the system's capacity.

Meanwhile, states currently using both IVR and AVT report high satisfaction from taxpayers. The State of Minnesota conducted a survey of customer satisfaction that revealed that the vast majority of taxpayers found their automated information system both easy to use and helpful. Similarly, an official with New York's taxpayer service division says that feedback regarding their use of these systems has been positive. Finally, DOR's Business Tax Manager says that the increase in tax tape usage that TIA experienced over the last year attests to the fact that people are satisfied with the AVT system.

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(1) The preliminary cost estimate includes IVR system hardware, installation, connection, application programming, and training for two DOR employees. The vendor states that training will allow DOR personnel to expand IVR as needed. In addition, the vendor estimates DOR will need additional telephone lines to support the IVR system. Although the costs for the lines should be minimal, actual cost will depend on DOR specifications. Costs could also increase if DOR chooses to extend the one-year warranty offered by the vendor. An extended warranty is available for approximately $7,500 annually and covers the cost of parts and labor.

(2) Based on an estimated 20,000 calls to be served by AVT expansion out of a previously identified unmet demand of 321,000 calls.

Technological remedies are most cost-efficient — The most cost-efficient way to satisfy taxpayer demand for information and assistance is to employ the technologies mentioned above. This becomes apparent based on the cost of additional staff positions that would be needed to meet the level of service that this technology promises to deliver.

TIA management estimates that one staff can respond to approximately 23,370 phone inquiries per year. Therefore, 10 FTEs would be required to answer the 240,000 calls that can be potentially handled by IVR and an expansion of the tax tape system. This additional staff would cost approximately $250,000 per year, or $1.04 per taxpayer served.[1]

In comparison, the addition of IVR and the expansion the tax tape system could potentially meet the needs of the same 240,000 taxpayers, without any staff additions. The total cost associated with IVR and the tax tape expansion is approximately $80,000, or about .33 cents per taxpayer served. Further, this is a one-time cost, as opposed to annual expenditures for staff additions.[2] It is clear that the most cost-efficient way to increase public access to information and assistance is to implement IVR and expand the tax tape system.

While the addition of IVR and expansion of the tax tape system will help DOR better meet the public demand, our analysis indicates that as many as 81,000 calls may still go unanswered during a given year. DOR will need to monitor this remaining unmet demand and determine if other options, such as additional staffing, may be needed to address it.

RECOMMENDATIONS

1. The Legislature should consider improving telephone access by appropriating funds to DOR specifically for the purchase and installation of:

   a) an Interactive Voice Response system; and

   b) the expansion of the tax tape system (AVT).

2. DOR should develop cost estimates for the purchase of an IVR system and expansion of AVT and provide these estimates to the Legislature.

3. DOR should continue to monitor demand for phone access and make adjustments in technology and staffing to meet this demand.

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(1) The costs include salaries, employee-related expenses, additional phones, furniture, and supplies.

(2) DOR may incur additional internal programming costs as management modifies or expands the system.

FINDING IV

DOR NEEDS TO IMPROVE ITS UNCLAIMED PROPERTY PROGRAM

DOR needs to develop a more aggressive unclaimed property program to collect abandoned property and, where possible, return it to rightful owners or their heirs. The Department's current efforts are inadequate. We found the State could have returned an additional $800,000 to rightful owners in 1994 by using some of the same techniques that it currently uses to find individuals who owe money to the State. Moreover, DOR could recover millions of dollars more in unclaimed property by reducing the period of time unclaimed property is held by financial institutions and other parties and improving the unclaimed property audit program.

A.R.S. §§44-301 through 44-340 requires DOR to collect abandoned property and attempt to return it to its rightful owners. Properties collected include inactive bank accounts, stocks, bonds, uncashed checks, and the contents of safe deposit boxes. Although some of this property is claimed by rightful owners, much of it remains unclaimed. The State has retained more than $80 million since the program began in 1956. While rightful owners or their heirs never lose their rights to the property, until the property is claimed, the State deposits much of it in the general fund and also uses it to fund various state programs, including the Unclaimed Property Unit. Statute also allows the fund to be used to provide shelter and job training for the homeless, low-income housing improvements and development, and utilities assistance for qualified individuals. For example, during fiscal year 1995, DOR collected unclaimed property worth approximately $15 million and returned about $3.5 million to rightful owners. Of the $11.5 million that was not claimed, approximately $6.4 million was deposited in the State's General Fund; $3.9 million was deposited in the Housing Fund; $545,000 was used to cover certain operating expenses for the Unclaimed Property Unit; and $628,000 was deposited in the Utilities Assistance Fund.

DOR Can Return More Property to Rightful Owners

DOR needs to develop a more comprehensive program to return property to rightful owners. The Department performs various activities in its attempt to locate owners of unclaimed property. However, DOR could improve its return rate by more fully utilizing locator tools readily available within the Department and adopting techniques used by more effective unclaimed property programs in other states. Streamlining the State's costly advertising strategy would enable DOR to reallocate funding to more effective locator techniques and tools.

DOR attempts to locate owners of unclaimed property by trying to match owner information with addresses in the Department's tax records and by advertising owners' names in local newspapers. In 1992, the department developed a computerized system known as the Warrant Information Tracking System (WITS) to locate addresses for owners of uncashed state warrants. The system matches social security numbers from unclaimed property accounts with addresses in taxpayer refund records and generates a letter to the owner. DOR expanded the system in June 1995 in its attempt to locate owners of other types of unclaimed property. In its first attempt, DOR reportedly matched about 8,700 of 36,000 account owners. If an unclaimed property account does not match any information found in tax records, or if the notice sent to the owner is returned, DOR advertises the owner's name in a newspaper in the county of the owner's last known address. However, DOR does not advertise names of owners it considers well-known because it feels these owners could be easily contacted.

More effective techniques will improve return rates — Our analysis indicates that DOR can improve its current return rate. During fiscal year 1995, DOR collected unclaimed property worth approximately $15 million and returned $3.5 million, or 23 percent, to rightful owners. Our analysis shows DOR could have returned an additional $830,000 million during the same period by employing readily available research techniques to find rightful owners.[1] The owners we located, which included some well-known organizations, were unaware the State was holding property for them. Other states utilize many of the techniques we applied to achieve return rates higher than Arizona's.

To locate owners of unclaimed property, we applied techniques used by other states and relied on the same tools DOR currently uses to find taxpayers who owe money to the State. We searched computerized national and regional telephone directories in public libraries for owners' current telephone numbers. For those owners not located through telephone directories, we obtained taxpayer information, such as individual income and business tax records, Motor Vehicle Division and Department of Economic Security records, and other information from DOR's Skip Trace Unit. Although the Unit's primary responsibility is to find individuals who owe money to the State, we found the information useful in locating owners of unclaimed property. Finally, we obtained information from credit bureau reports provided by the Skip Trace Unit for owners not located through other channels. With the exception of staff time, all activities were free except the credit bureau reports, which cost the Department no more than $1.40 each.

Based on our sample, we estimate DOR could have returned an additional $830,000 to rightful owners by applying the techniques and resources mentioned above. We located owners for 57 of the 150 accounts sampled. We selected our sample from unclaimed

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(1) We located owners for 38 percent of the owners in our sample of 150 unclaimed property accounts. To estimate additional potential returns, we calculated a weighted average which included categories of property accounts worth $250 to $500, $501 to $1,000, $1,001 to $5,000, $5,001 to $10,000, and $10,001 and above. We multiplied the weighted average for account values by the number of additional owners we estimate DOR could have located, based on our sample results, to estimate additional returns at $836,219.

property accounts received by DOR during 1994. Although DOR should have advertised and/or sent a notice to the owner's last known address for each of these accounts, the property remained unclaimed by the owners. As shown in the examples below, our sample also included some accounts belonging to well-known owners that the Department either did not advertise or take additional steps to return the property. More than half of the owners we located were found through phone directories. The remaining owners were located with information gathered from DOR's Skip Trace Unit.

- In November 1994, DOR received a substantial amount of unclaimed property belonging to San Xavier Mission del Bac located near Tucson. DOR chose not to include the account in its February 1995 advertisement, apparently intending to notify the Mission by mail. However, when we contacted the Mission's administrator by telephone in July 1995, he said he was unaware the State was holding property for the Mission. The Mission has since claimed its property.

- DOR received unclaimed property worth a substantial amount belonging to the Navajo Nation Social Services Agency located in Window Rock. DOR did not advertise the account in its February 1995 advertisement nor is there any record of DOR notifying the owner. When we contacted the agency in July 1995, an official of the Navajo Nation said he was unaware of the property held by DOR.

- DOR did not advertise and had not returned unclaimed property belonging to Arizona State University in Tempe. Although DOR's computer system shows that DOR had sent the University a notice in January 1995, the property remained unclaimed through June 1995. When we contacted the University's comptroller, he told us he was unaware of the property and would file a claim with DOR. The University has since claimed its property.

Other states are more aggressive at locating owners — Arizona could improve its return rate by adopting more effective locator methods used by other states. While Arizona has generally relied on newspaper advertising to locate unclaimed property owners, most effective state programs combine newspaper advertising with additional research techniques and tools to increase property return rates. For example, states with more effective unclaimed property programs, such as Utah, Texas, Colorado, Rhode Island, and Louisiana, have return rates above Arizona's. We found that some of these effective programs have staff who find owners using a variety of resources, including national and regional telephone directories, income tax records, motor vehicle records, credit bureau reports, commercial mailing lists, and social security number indexes. These methods are effective for locating owners for those accounts without a valid social security number or when the owner resides out-of-state. In addition, most of these states also perform outreach activities, such as publicity campaigns and visits to state and county fairs and shopping malls, to increase public awareness. Moreover, some states are using electronic media outlets, such as the Internet and information booths, to make unclaimed property information readily available to the public.

Reallocating resources could fund additional activities — The State could reduce its emphasis on costly advertising and use monies saved to fund a more effective program to locate rightful owners. The Unclaimed Property Unit currently lacks staffing and resources to actively seek owners who do not respond to advertisements or notices. Other states advertise fewer times than Arizona, have lower advertising costs, and use a combination of techniques and tools, including full-time locators, to find owners. Further, unclaimed property experts agree our advertising requirements are not cost-effective.

Unclaimed property advertising requirements are costly. The program's statutorily mandated advertising policy requires publishing names of owners with property worth $50 or more for two consecutive weeks prior to March and September. Names appear in the county of the owner's last known address. During fiscal year 1995, DOR spent nearly $350,000 on advertising — approximately $20.75 for each of the 16,813 names listed. Printing an annual list of all owners and placing it in area newspapers could cut costs by as much as $175,000 and better reach owners who have moved across county lines.

Other states and experts prefer a more cost-effective advertising strategy. Of the 17 states we surveyed, only 3 states advertise 4 times per year like Arizona. In fact, most states we surveyed advertise one to two times per year and pay between $1 and $6 per name listed — significantly less than Arizona's average of $20 per name. In addition, the National Conference of Commissioners on Uniform State Laws has proposed a new uniform unclaimed property act that recommends reducing advertising requirements to once per year. The act would replace the 1981 Uniform Unclaimed Property Act that Arizona and other states have adopted.

Savings from lowering advertising costs in Arizona could be used to fund effective locator tools such as computerized telephone directories, credit reports, and outreach activities.

DOR Could Collect More Unclaimed Property from Financial Institutions and Other Parties

Arizona could collect millions of dollars more in unclaimed property by reducing the period of time most property types are held by financial institutions and other parties and by improving its unclaimed property audit program. Experiences here and in other states indicate that reducing the current holding period for unclaimed property could increase collections by as much as $25 million the first year. Moreover, DOR could collect even more unclaimed property by improving its unclaimed property audit program.

In Arizona, holders of unclaimed property, such as banks, insurance companies, and other private businesses, retain most types of unclaimed property for five years after losing contact with the rightful owner. Properties held for five years include savings and checking accounts, cashier and certified checks, and employee wages. Other property, such as utilities

deposits and refunds, is held for two years. When the holding period expires, holders are required by statute to remit the property to DOR.

Reduced holding periods will significantly increase collection — According to experts and the experiences of other states, shorter holding periods would significantly increase collections of unclaimed property. Unclaimed property experts indicate there is a growing trend among states to reduce the period of time property is held, resulting in increased collection of unclaimed property. According to experts, states collect more unclaimed property because holders turn property over to the State sooner. Also, shorter holding periods can increase awareness of unclaimed property laws and encourage greater compliance among holders, which can increase collections. In addition, shorter holding periods benefit holders of unclaimed property by reducing the length of time records must be kept. Also, since shorter holding periods provide more recent information on rightful owners, states are able to return more property to owners and better protect it from holder service charges.

Other states have reduced holding periods and a national organization with expertise in unclaimed property recently proposed shorter holding periods as well. Several states we contacted, including California, Iowa, Minnesota, and Rhode Island, have dropped holding periods for most types of unclaimed property from as high as seven years down to three years. Many other states have reduced holding periods for other types of property, such as checks and utilities deposits and refunds, to one year. According to officials from these states, reducing holding periods has significantly increased unclaimed property collections. For example, Minnesota reduced holding periods from 5 years to 3 in 1994 and increased collections from $8 million in fiscal year 1993 to $22 million in fiscal year 1994. Minnesota state officials estimate fiscal year 1995 collections at more than $16 million. In addition, the National Conference of Commissioners on Uniform State Laws recently proposed shorter holding periods in its new uniform unclaimed property act. The new act recommends states reduce holding periods for 11 of 18 property types.

Similarly, in 1989, when Arizona reduced holding periods for most types of unclaimed property from 7 to 5 years, collections increased from about $5 million to $15 million the first year, and have not dropped below $11.5 million since. Based on experiences here and in other states, Arizona has the potential to initially collect an additional $25 million by further reducing holding periods from five to three years for most property, such as checking accounts and cashier and certified checks, and even lower for other types of property, such as wages and utilities deposits and refunds. According to DOR's unclaimed property program administrator, reducing holding periods could enable the State to maintain collection levels for subsequent years at about $20 million. Experts we spoke with believe heightened awareness and improved compliance among holders may cause collections to remain higher in subsequent years.

A more effective audit program could increase collections and improve compliance — An improved unclaimed property audit program could recover additional revenue for the State and improve compliance. DOR's unclaimed property auditors are less effective than auditors

in other states. To improve the effectiveness of its audit function, DOR should adopt several methods used by more effective states.

DOR's unclaimed property auditors are less effective than those in other states. For fiscal year 1995, the 2 unclaimed property auditors conducted 12 audits and assessed $443,000 in unclaimed property from holders. This is approximately $150 in unclaimed property assessments per audit hour.[1] DOR's audit function, however, is not as effective as in other states. For example, unclaimed property auditors in states with more effective audit programs typically assess more than $400 per audit hour.

To improve the effectiveness of its unclaimed property audit function, the Department should adopt several methods used by more effective states. Specifically, DOR needs to audit financial institutions and other parties with the greatest potential for unclaimed property, and increase staffing to include a full-time auditor to ensure holders are properly remitting unclaimed property to the State.

- DOR needs to audit financial institutions and other parties with the greatest potential for having unclaimed property. Currently, DOR's two unclaimed property auditors conduct a few audits in each of several industries. Other states have already identified industries with the most potential for having unclaimed property. DOR's unclaimed property auditors should audit potentially large holders of unclaimed property, such as financial institutions, utilities, hospitals, and courts, rather than continue to sample other industries such as car dealerships and temporary employment agencies, that may be less likely to possess a large amount of unclaimed property.

- DOR needs to increase the number of unclaimed property audit staff to increase revenues and improve compliance. The experiences of other states suggest that DOR could increase revenues and improve compliance by hiring a full-time auditor. The auditor can identify and contact hundreds of financial institutions and other parties each year who may be either underreporting unclaimed property to DOR or not reporting any at all. In fact, other states have found these auditors are more cost-effective than field auditors. For example, Texas' unclaimed property unit has a staff of 7 field auditors who conducted 45 audits and collected $5.4 million in unclaimed property during fiscal year 1994. However, during the same period, four other auditors contacted more than 1,000 financial institutions and other parties and collected more than $6 million in unclaimed property. Although DOR has reestablished a similar function, the staff person has other responsibilities within the unclaimed property unit and is, therefore, not as effective as an employee who contacts holders of unclaimed property full-time. Also, DOR may be able to transfer staff from another audit unit rather than request additional funding in its budget.

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[1] DOR does not track actual hours spent per audit. Our productivity estimate is based on a 75 percent productivity level for 2,080 hours available per year per employee. (.75 x 2,080 = 1,560 hours available; 2 employees x 1,560 hours = 3,120 total; $443,000 assessed/3,120 = $141.98.)

RECOMMENDATIONS

1. The Legislature should consider amending A.R.S. §44-318 to reduce paid newspaper advertising from four times a year to one time per year, and use savings to fund additional locator services.

2. The Legislature should consider amending A.R.S. §§44-302 through 44-316 to reduce holding periods on most property types.

3. DOR should adopt more effective locator methods used by model states. Specifically, DOR should request in its budget funding to hire a full-time locator to identify owners and return property by using more effective techniques and outreach activities.

4. DOR should develop a more effective unclaimed property audit function. Specifically:

   a) Since DOR has limited audit resources, DOR needs to focus field audit efforts on financial institutions and other parties with the most potential for unclaimed property, and;

   b) DOR needs to increase the number of audit staff to improve compliance and refer uncooperative holders to field auditors.

FINDING V

DOR NEEDS TO IMPROVE ITS ENFORCEMENT OF BINGO STATUTES

The Department of Revenue's Bingo Enforcement Unit needs to ensure complaints are fully investigated and enforce bingo statutes. The bingo industry, which involves large amounts of cash, creates opportunities for individuals to skim proceeds and misuse funds. To prevent these occurrences, strong enforcement is needed. Since 1989, the Department has not made certain that potentially criminal cases are investigated. To ensure the integrity of charitable gaming in Arizona, DOR and the Legislature should consider several options to improve enforcement of bingo statutes.

A.R.S. §§5-401 through 5-415 require DOR to "investigate compliance... for the purposes of enforcing" bingo statutes. DOR currently regulates approximately 800 small, medium, and large bingo licensees. Many of these licensees are qualified charitable and nonprofit organizations. During fiscal year 1995, bingo licensees reported gross receipts of approximately $50 million and DOR collected approximately $900,000 from license fees and a percentage of gross receipts after prize payouts. DOR employs one administrator, four investigators, and five staff to perform administrative duties such as licensing and education.

DOR Has Failed to Investigate Potential Criminal Violations

The Department has not adequately investigated complaints involving potential criminal violations of bingo statutes. DOR receives approximately 200 complaints each year, some of which allege criminal violations such as theft, embezzlement, and misappropriation of bingo funds. Although DOR has the statutory authority and responsibility to investigate and enforce violations of bingo statutes, DOR has an agreement with the Department of Public Safety (DPS) to investigate alleged criminal violations. However, few cases have been investigated since the intergovernmental agreement was established in 1989. As a result, possible criminal activity within charitable gaming may be continuing unchecked, thereby harming gaming patrons and damaging the credibility of charitable and nonprofit organizations. Moreover, charitable gaming experts suggest enforcement is important.

DOR receives many complaints, the most serious of which have not been investigated— Between 1989 and 1994 DOR received an average of 230 complaints annually involving bingo licensees. Complaints are reviewed by DOR, and cases involving possible criminal activity are referred to DPS as part of an intergovernmental agreement established between the two agencies in 1989. As shown in Table 2 (see page 26), 124 of the 1,391 cases received by DOR between 1989 and 1994 have been referred to DPS for investigation since the

inception of the intergovernmental agreement. The nature of these referrals ranged from allegations of cheating to possible theft and embezzlement of bingo funds by employees and operators. As of August 1995, DPS' Criminal Investigations Unit had investigated only 15 of 124 complaints involving possible criminal violations.

Table 2

Status of Bingo Complaints Investigated by DPS 1989 through 1994

Year	Complaints Received by DOR	Complaints Referred to DPS	Complaints Investigated by DPS
1989	193	8	0
1990	145	9	0
1991	174	27	0
1992	291	22	1
1993	243	19	0
1994	345	39	14
Total	1,391	124	15

Source: Auditor General staff analysis of Department of Revenue and Department of Public Safety records.

Cases need to be investigated — Possible criminal violations of bingo statutes need to be investigated. According to charitable gaming experts, criminal activity in charitable gaming, if left uninvestigated, can harm gaming patrons and damage the credibility of charitable and nonprofit organizations. Our review of complaints that were not investigated illustrates the importance of strong enforcement. For example:

- In 1993, two organizations that advocate for senior citizens filed a report with DOR alleging that a bingo-funded charity that provides a group home and transportation services for the elderly was misusing funds. A preliminary review by DOR revealed the director of the charity was using bingo funds to make improvements on his private residence. In addition, the review also found the charity did not provide much-needed transportation services to elderly clients, even though the director regularly reported transportation expenses on monthly bingo reports for more than two years. To date, DPS has not investigated this case.

- In 1994, several members of a Phoenix charity visited DOR to report that their bingo manager was allegedly engaged in felonious activities, including misappropriation

of funds for personal use and filing false monthly bingo reports. The charity's board fired the manager and requested that charges be filed against the person. DOR forwarded the complaint to DPS for investigation. To date, however, neither DPS nor DOR has taken further action.

According to DPS officials, DPS has not investigated cases involving violations of bingo statutes due to resource limitations and because these cases often involve less serious criminal activity than other cases they routinely investigate. For example, violent crimes, narcotics cases, conspiracy-related crimes, and other crimes all take precedence over bingo-related investigations. Although DPS considers bingo cases to be a low priority, a charitable gaming expert noted that even though bingo revenues in Arizona are relatively small, complaints should be investigated because of the cash involved in the bingo industry and because the potential for skimming funds tends to attract criminal activity.

Even though DOR has an intergovernmental agreement with DPS to investigate cases, this agreement does not relieve DOR of any obligation or responsibility imposed upon it by law. Therefore, if DPS is not investigating cases, DOR still needs to conduct investigations to ensure bingo statutes are enforced and the public is protected.

Several Options Available to Improve Enforcement

DOR and the Legislature should consider several options to improve enforcement of bingo statutes. Specifically, the Department should either resume its efforts to fully investigate complaints and enforce bingo statutes or provide DPS with additional resources to ensure complaints referred by DOR are adequately investigated. As another option, the Legislature could consider moving the Bingo Enforcement Unit out of DOR and relocating it to a more enforcement-oriented agency such as the State Gaming Agency.

Because bingo enforcement is ultimately the responsibility of DOR, DOR could resume directly investigating complaints. If DOR resumes investigating complaints and enforcing bingo statutes, it may need additional resources to perform these duties or to contract with another agency to provide these services. While DOR deposited more than $900,000 in licensing fees and bingo taxes in the state general fund during fiscal year 1994-95, the Bingo Enforcement Unit operated on a budget of approximately $300,000. Previously, when DOR had its own investigative staff, the Bingo Enforcement Unit's budget was approximately $500,000 annually. To ensure that complaints are adequately investigated, DOR may need to request more bingo revenues to hire additional investigators. However, appropriating additional funds to DOR may not be effective since our previous performance audit reports in 1985 and 1988 found DOR's enforcement efforts inadequate.

Alternatively, DOR could improve enforcement by amending its intergovernmental agreement to provide DPS with additional resources to cover the cost of investigating complaints. The current intergovernmental agreement does not reimburse DPS for the cost of investigating complaints referred by DOR. DPS has cited resource limitations as one reason for not fully investigating these complaints. DOR could request more bingo revenues to enable it to contract with DPS to allocate staff specifically to investigate complaints and enforce bingo statutes.

Another option for legislative consideration is transferring the function and authority of DOR's Bingo Enforcement Unit to a more enforcement-oriented agency such as the State Gaming Agency. Created in 1992, the State Gaming Agency is responsible for enforcing gaming compacts between the State and various Indian tribes. Enforcement of tribal gaming compacts involves many of the same processes required for enforcement of bingo statutes. Further, other states such as Washington and North Dakota have successfully placed bingo and casino-style Indian gaming within the same department for enforcement purposes.

Although relocating the Bingo Enforcement Unit to the State Gaming Agency offers certain advantages, the Director of the State Gaming Agency does not support such a move. According to the Director, requiring the agency to enforce bingo statutes would pose an administrative burden on the agency. In addition, the Director believes that placing bingo and Indian gaming within the same department for enforcement purposes could result in the appearance of an expansion of gaming in the State and he is concerned about possible legal complications.

Also, although DOR's Director believes the Department has done a good job of administering the bingo statutes, he would not oppose transferring the function to another agency. The Director, however, believes such a transfer should meet two conditions: administration of the bingo statutes needs to be as good or better than what DOR currently provides, and the administration of bingo statutes falls on an agency that wants the responsibility.

RECOMMENDATIONS

1. If the function of the Bingo Enforcement Unit remains at DOR, DOR should either resume its efforts to fully investigate complaints and enforce bingo statutes or provide DPS with additional resources to ensure complaints referred by DOR are adequately investigated.

2. If DOR cannot ensure improved enforcement, the Legislature should consider transferring the function and authority of DOR's Bingo Enforcement Unit to a more enforcement-oriented agency such as the State Gaming Agency.

Agency Response

ARIZONA DEPARTMENT OF REVENUE

1600 WEST MONROE - PHOENIX, ARIZONA 85007-2650

FIFE SYMINGTON
GOVERNOR

HAROLD SCOTT
DIRECTOR

December 7, 1995

Mr. Douglas R. Norton, Auditor General
Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, AZ 85018-7243

Dear Mr. Norton:

We have reviewed the final report of your performance audit of the Administrative Services and Taxpayer Support Divisions of the Department of Revenue. Following are our general comments on some of the findings and specific responses to each recommendation:

FINDING I

Recommendation 1. The Legislature should consider amending A.R.S. §42-1322 to establish a specific filing date for EFT payments.

This legislative change is required to effect increased interest earnings. If EFT is implemented for transaction privilege tax with current filing laws, the state will lose interest, not gain interest.

Recommendation 2. To improve tax processing efficiency and increase revenue, DOR should establish an EFT program for sales tax collection.

The Department of Revenue has implemented EFT on a carefully planned phased approach, lowering threshold requirements and adding additional tax types when we were certain it was justified and could be done efficiently and effectively for both DOR and the taxpayers. The last phase of the plan is (and always has been) transaction privilege tax. Also, see concerns expressed in response to Recommendation 1 above.

Recommendation 3. DOR should require taxpayers with a liability in excess of $20,000 per filing period in corporate estimated income and withholding taxes to remit tax payments using EFT.

This is the threshold we intend to implement ultimately and will do so when we are certain it can be done efficiently and effectively with the least amount of disruption for both DOR and the affected taxpayers.

FINDING II

Recommendation 1. The Legislature should consider amending A.R.S. §42-1451 to allow DOR to charge an administrative fee for collection and administration of local taxes.

The implications of this recommendation for the businesses in the state should be included in the discussion so the Legislature can have a more complete picture before considering this statutory change and the inherent policy implications. The consensus of the Legislature seems to be that government is too intrusive and should be curtailed, not expanded. The side effect of this recommendation would be an expansion of government as some cities opt out of the state collections program, and thus impose additional burdens on businesses within their jurisdiction.

Recommendation 2. DOR should determine an administrative fee for collecting and administering local jurisdiction taxes based on a comprehensive cost study.

If directed to do so by the Legislature, DOR will undertake this cost study.

FINDING III

While we agree there is potential for improved taxpayer service through the purchase of IVR systems, there are several problems with the finding and recommendation as presented. The report understates cost and overstates service level improvement.

As indicated previously to the auditors, we disagree with the potential impact of IVR and its cost estimates as presented. This does not mean we disagree that IVR has potential to make a significant impact on our service level, however. The problems with the impact statement fall in two areas. They are the number of calls that can be answered mechanically versus manually and the projection of these to the calls made. After the auditors initially advised us of their intent to recommend IVR, our Taxpayer Information and Assistance section conducted a two week test to identify which calls by category were in fact simple enough for a machine reply. That indicated 1/4 of the calls we manually answered could have been handled by IVR. The difference between our test and the auditor estimate is we segregated calls more finely. The second issue was in projecting the impact on calls estimated as busy. The department estimate is that the most optimistic

scenario would reduce the busy signal percentages to 38%. Actual impacts would be less however. Our busy signal studies indicate call volumes fluctuate wildly from one hour to another in any given day. Projections assume a level flow. Because the volumes from one hour to another can vary as much as three or four hundred percent, actual busy signal rates will perforce be higher than projections.

Also, the projected cost of the IVR can vary significantly depending on the configuration installed. Estimates given DOR from one vendor contain numerous caveats, and discussions with other states also indicate that costs can vary widely. We must note that since income tax refund status is not a significant problem in Arizona due to our excellent turn around times, we had to go to other types of calls for potential IVR applications. These involve multiple systems and present different interface requirements and as many as 15 different types of inquiries. The variety and complexity of the programs we would have to offer to make IVR viable are the same features which tend to make the cost escalate.

Recommendation 1. The Legislature should consider improving telephone access by appropriating funds to DOR specifically for the purchase and installation of:

a) an Interactive Voice Response system; and

b) the expansion of the tax tape system (AVT).

The department supports this recommendation.

Recommendation 2. DOR should develop cost estimates for the purchase of an IVR system and expansion of AVT and provide these estimates to the Legislature.

The department will prepare a Request for Proposal for IVR contingent upon legislative appropriation for such an effort. IVR provides a valuable possible increase in service even if it is less than estimated by the Auditor General.

Recommendation 3. DOR should continue to monitor demand for phone access and make adjustments in technology and staffing to meet this demand.

The department has been and will continue monitoring this and making any appropriate adjustments possible within the constraints of our appropriated budget.

FINDING IV

LEGISLATIVE CHANGES. The report recommends two major legislative changes. First, the Auditor General recommends cutting the frequency of legally required advertising of unclaimed property. Second, the report recommends reducing the time

holders of property hold unclaimed funds prior to remitting them to the state. If either of these recommendations is approved by the Legislature, funds would be available to fund a "locator" or two to target high dollar accounts. If the Legislature desires the department to pursue this approach, the department's budget will have to be modified to reflect this desire.

RECENT DOR IMPROVEMENTS. The report does not sufficiently recognize the improvements the Department has already made in the unclaimed property program. For example, Arizona is a model state in regard to its automation of the holder reporting process, making it easier for holders to remit property to DOR. Logically, the easier the reporting is for holders, the greater the likelihood of reporting, resulting in more property remitted to the State. Neither our significant cost-saving move of changing from display ads to an advertising supplement nor our increase in auditing through privatization are recognized. Last fiscal year, this privatization generated about $2.5 million in additional property remitted to DOR. Finally, enhancements in automation have resulted in matching thousands of names with more current addresses, thereby substantially improving our efforts in locating more owners.

"WELL-KNOWN OWNERS". The report provides the misleading and erroneous impression that DOR is unable to identify and locate well-known organizations. DOR is able to identify these organizations as noted by the fact that the names of well-known organizations do not appear in any newspaper advertising. Returning the property to the owner is a matter of timing and resources as to when a claim form is sent and the degree of follow-up that is done when an organization simply does not respond to the letter. Many times, even after contact by DOR, the owner fails to submit a claim for one reason or another. This phenomena exhibited itself even with some of the owners contacted by the Auditor General staff.

ONE-ON-ONE MANUAL LOCATOR EFFORT. During the course of the audit, the Auditor General's staff sampled 150 of the accounts remitted in 1994 to determine if they could locate the owners. However, only accounts over $250 were selected, which are representative of only 15% of the accounts remitted in 1994. The other 85% of the accounts, the vast majority, were ignored by this "cherry-picking" of the high dollar accounts. DOR has a responsibility to all of the citizens with unclaimed property to attempt to locate them and cannot restrict its efforts to accounts with more money.

The Auditor General's staff generally used a one-on-one approach to locating owners during the audit and has recommended that an additional locator be hired. The analysis does not indicate the actual amount of time spent in the locating effort, so an evaluation of the efficiency and actual cost of this method is not possible. One additional locator position will not make much of a dent in locating owners on a one-on-one basis. We estimate that one additional locator using a one-on-one approach would only be able to locate fewer than 3% of the new owners on an annual basis. We strongly feel our current

and upcoming efforts to use more automated means to find current addresses of large volumes of owners will be more cost-effective and will enable us to better fulfill our obligation to the majority of citizens with unclaimed property. Using automated means has already been very successful, and we expect it to continue to be successful. In fact, we expect future resources to be needed more in the area of processing the large volume of claims we expect to receive as a result of our automated searches for current addresses.

COMPARISON WITH OTHER STATES. The comparisons with other states of the effectiveness in returning property to the rightful owners based on dollars returned is subject to significant "skewing" of the results. The presence of a few unusually large dollar returns can mask an otherwise poor performance and impact the comparative rankings. For example, a comparison with the same states (the "model" states identified in the report) using a different year's statistics presents a much more favorable picture for Arizona. The point is, statistics vary from year to year based on the mix of property involved.

Recommendation 1. The Legislature should consider amending A.R.S. §44-318 to reduce paid newspaper advertising from four times a year to one time per year, and use savings to fund additional locator services.

The department has no objections to this recommendation as long as it is clear that some of the savings to the unclaimed property fund are to be redirected to DOR locator efforts.

Recommendation 2. The Legislature should consider amending A.R.S. §44-302 through 44-316 to reduce holding periods on most property types.

The department has no objections to this recommendation.

Recommendation 3. DOR should adopt more effective locator methods used by model states. Specifically, DOR should request in its budget funding to hire a full-time locator to identify owners and return property by using more effective techniques and outreach activities.

The department has continually sought to improve its locator methods and great improvements have been made, particularly in the area of automated matching systems. We will continue in these efforts. As indicated in the narrative above, the department does not feel the hiring of a full-time locator will have a particularly significant effect on the number of accounts returned to owners, but we are willing to pilot test this in addition to our automated efforts. It is our belief that funding for such a position should come from the Unclaimed Property fund, not General Fund monies. However, we also feel there is a greater need for additional staff to process the claims generated by the more effective locating methods being used.

Recommendation 4. DOR should develop a more effective unclaimed property audit function. Specifically:

a) Since DOR has limited audit resources, DOR needs to focus field audit efforts on financial institutions and other parties with the most potential for unclaimed property, and;

b) DOR needs to increase the number of audit staff to improve compliance and refer uncooperative holders to field auditors.

The department continually reevaluates all audit programs for effectiveness and productivity and will consider this recommendation in these reevaluations. Any additional audit staff should be funded by the Unclaimed Property fund, not General Fund monies. Given such direction by the Legislature, the department will proceed with this.

FINDING V

From the onset, the audit focused on only one responsibility of the Bingo program, the enforcement and investigative responsibility. There was no review of the licensing and education responsibilities of the program, which the Department has performed exceptionally well. These are very important responsibilities which go far to ensure that fair and legal bingo games are operated in accordance with State statutes. Licensees have overwhelmingly complimented the Bingo Section's education efforts and service.

INVESTIGATION EFFORTS. The report points out that the Department of Public Safety has not investigated all of the allegations relating to bingo that DOR referred to it. Without trivializing the allegations, it is important to note that none of the allegations that DPS felt warranted investigation resulted in criminal prosecution or even the pursuit of criminal prosecution. Further, DPS has had to prioritize the bingo cases in relation to the other criminal cases it must handle.

Recommendation 1. If the function of the Bingo Enforcement Unit remains at DOR, DOR should either resume its efforts to fully investigate complaints and enforce bingo statutes or provide DPS with additional resources to ensure complaints referred by DOR are adequately investigated.

If the Legislature wants an aggressive Bingo investigations program, they could authorize the use of Bingo revenues to fund one or two full-time investigators either at DOR or at DPS to concentrate on bingo cases on behalf of DOR.

Recommendation 2. If DOR cannot ensure improved enforcement, the Legislature should consider transferring the function and authority of DOR's Bingo Enforcement Unit to a more enforcement-oriented agency such as the State Gaming Agency.

The department is proud of the job it has done administering the bingo statutes but would not oppose transferring the function to another agency only if the transfer would not result in deterioration of the service provided to the licensees and of overall administration of the bingo statutes, and the function is given to an agency that truly wants the responsibility.

Sincerely,

Harold Scott

Harold Scott
Director