PERFORMANCE AUDIT

DEPARTMENT OF REVENUE

COLLECTIONS SECTION

Report to the Arizona Legislature
By the Auditor General
December 1995
Report #95-17

DOUGLAS R. NORTON, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
DEPUTY AUDITOR GENERAL

December 19, 1995

Members of the Arizona Legislature

The Honorable Fife Symington, Governor

Mr. Harold Scott, Director
Department of Revenue

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Department of Revenue - Collections Section. 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. §§ 41-2951 through 41-2957. This is the third in a series of four reports to be issued on the Department of Revenue.

This report addresses improvements needed to make the Department's collections function more productive and also recognizes improvements made since our last review in 1988. The amount of delinquent taxes owed the State has grown 93 percent in the past six fiscal years. Delinquent taxes, excluding bankruptcy and other uncollectible accounts, now exceed $205 million. We identify several procedural changes DOR can implement to collect more of these monies. We also recommend that DOR add 18 field collectors which will increase collections by over $6 million annually. Comparing DOR's information with other state agencies' databases would also increase collections by identifying sources of income for delinquent tax payments. Incorporating a debtor profiling process could also increase collections by more quickly focusing enforcement efforts on those accounts deemed less likely to be collected.

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 20, 1995.

Sincerely,

Douglas R. Norton

Douglas R. Norton
Auditor General

2910 NORTH 44TH STREET • SUITE 410 • PHOENIX, ARIZONA 85018 • (602) 553-0333 • FAX (602) 553-0051

SUMMARY

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Revenue (DOR), Collections Section, 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 is the third in a series of four audits of DOR conducted by our Office.

Ninety-five percent of taxes owed to the State are paid in the correct amount and on time. Typically, when taxpayers are delinquent, DOR first mails a series of reminder letters. If taxpayers then fail to pay in full, DOR routes the account to the Collections Section. Collections staff, using phone contacts and letters, ask taxpayers to make full payment. If taxpayers cannot, payment agreements can be established. For those unwilling to cooperate, DOR can levy wages and bank accounts, file liens against property, and in extreme cases seize property. The few taxpayers who are delinquent account for a significant amount of money owed to the State; a total of $356 million at the end of fiscal year 1995.

Improvements Made Since Prior Report, But Collections Gap Increasing

DOR has taken a number of steps to improve its collection function since our 1988 audit report was issued. As recommended in our previous report, DOR purchased and implemented an autodialing enhancement to its automated collection system to minimize the time collectors spent on nonproductive calls. The Office Collections Unit experienced a $14.5 million increase in the tax dollars collected from delinquent accounts in the year following implementation of the autodialer and other enhancements, and collections have remained at this higher level through 1995. The Department also extended its phone collection hours to improve the telephone contact rate and provide better customer service. DOR significantly expanded its efforts to ferret out unlocated accounts (skip-tracing), and now averages more than six times as many successful skip-traces annually as in 1988. Finally, the Department has taken steps to improve supervision and training of its collection staff.

Despite these improvements, DOR has not kept pace in collecting delinquent taxes. Delinquent taxes owed to the State, excluding bankruptcy and other "uncollectible" accounts, have grown from $106 million at the end of fiscal year 1989 to $205 million at the end of fiscal year 1995, a 93 percent increase. In contrast, DOR's success at collecting delinquent taxes has plateaued, averaging approximately $125 million over the past five years. As a result, DOR has been collecting a smaller percentage of total delinquent tax dollars in recent years than in the past. In fiscal year 1989, DOR collected 80 percent of all net delinquent taxes

owed the State. In contrast, DOR collected only 63 percent of total net delinquent tax dollars in fiscal year 1995. Our audit findings outline reasons why DOR's performance has declined and present recommendations that specify how millions in additional delinquent tax revenues could be collected.

Better Use of Existing Enforcement Tools and Adoption of New Collection Methods Could Enable DOR to Collect Millions More in Delinquent Taxes (See pages 5 through 14)

DOR could generate millions in additional revenue by following levy and lien guidelines, using automatic withdrawal from taxpayer bank accounts for installment agreement payments, and allowing taxpayers to pay their debt with credit cards. Our review found that DOR collectors were, in many cases, not following the Department's wage and bank account levy and property lien guidelines. These are powerful tools that can be used to enforce collection of delinquent tax debts. An examination of a statistically valid sample of 200 accounts levied by the Department in June 1994 found collectors complied with DOR guidelines in slightly less than 25 percent of all cases. An analysis of these cases showed that levies done according to DOR guidelines were more likely to capture the monies owed to the State than those cases in which guidelines were not followed. Twenty-nine percent of the accounts levied per DOR guidelines captured all monies owed to the State, while only 13 percent of the cases in which levy guidelines were not followed captured the entire tax debt. If all of these levies complied with DOR guidelines, we estimate that the Department could have collected as much as $2.6 million more from levied accounts.

DOR can also increase collections by requiring taxpayers with bank accounts to use automatic withdrawal to make monthly payments. This is a common practice with mortgage companies, utilities, and other private and public sector entities. Currently, estimates are that from 50 to 80 percent of the taxpayers on installment agreements fail to make all of their payments as agreed upon. In March 1995, there were approximately 26,500 accounts, with a total value of nearly $39 million, on payment agreements with the Department. Given the high broken promise rate it appears that millions of dollars go uncollected. To address this, Minnesota has instituted an automatic withdrawal program for taxpayers on payment agreements. After 15 months, Minnesota found that 65 percent of those with automatic withdrawal paid in full, while only 18 percent of those on voluntary payment agreements paid in full.

Allowing the use of credit cards to pay delinquent taxes should also be incorporated. Ten states already use this method to collect delinquent taxes. DOR has approximately 72,000 delinquent accounts with balances less than $1,000. These accounts, with a total due of approximately $22.9 million, could be targeted for credit card payments. Allowing credit card payments could accelerate payment of these debts and reduce the cost of collecting monies

owed. Banks processing credit card transactions generally charge a fee of 1.5 to 3 percent, which is less than it would cost DOR to collect these accounts. However, statutes would need to be revised to allow DOR to pay the fee.

Increased Staff Could Result in Collection of an Estimated $6.6 Million in Additional Delinquent Tax Debts (See pages 15 through 20)

DOR needs to add staff to address its growing delinquent tax account balance. Although dollar value of delinquent accounts has increased from $106 to $205 million over the past six years, DOR has added relatively few collection staff to meet increased workload demands. For example, the average collector caseload in the Field Collections Unit has more than doubled since fiscal year 1990, from 183 accounts per collector to 498. As a result, many cases are not actively addressed. An additional 18 field collectors could increase net delinquent tax dollars collected by an estimated $6.6 million annually. Cost for these positions is estimated to be approximately $870,000 in the first year. However, the Department recently transferred six positions from its Individual Income Tax Audit Section to the Field Collections Unit. Further intra-agency transfers to the Collections Section may be feasible, thereby reducing the cost of new field collector positions.

DOR Could Enhance Delinquent Tax Collection by Using Other State Agencies' Databases (See pages 21 through 26)

DOR can utilize database information from other state agencies to improve delinquent tax collections. A comparison of DOR's delinquent taxpayer account information and Department of Administration (DOA) state employee and vendor records found 1,355 state employees owed $1,906,963, and 589 vendors owed $1,933,898 in delinquent taxes. An analysis of DOR collections records found that only 49 percent of these state employees and 22 percent of these vendors, excluding bankruptcies, were on payment agreements to resolve their tax debts. The analysis also found that DOR had placed 47 state employee accounts in its "uncollectible" file, often because the taxpayer could not be located.

Some of the monies paid to these employees and vendors could possibly have been recovered by DOR for payment of tax delinquencies. State employee wages and vendor payments can provide a sound source of income to either pay tax debts in full or arrange payment agreements. For example, during the nine-month period of our review, over $500,000 was paid out by the State to vendors owing delinquent taxes. By comparing its information with DOA's databases, DOR can increase the opportunities to more effectively collect delinquent taxes. DOR agrees with the concept and is considering expanding its procedures to compare

records with the Department of Economic Security's unemployment tax database that includes information on employees of the majority of Arizona's employers.

Debtor Profiling Could Improve the Effectiveness of DOR's Collection Program (See pages 27 through 29)

DOR should consider implementing a debtor profiling program in the future to more effectively utilize its collection resources. Commonly used in business and already implemented by some states, debtor profiling ranks the probability of collecting each account based on several historical factors. This allows collections staff to focus stronger enforcement efforts on those accounts that have proven more difficult to collect, whereas accounts showing a better payment record are given more time before any action is taken.

DOR should approach debtor profiling in two ways. First,the agency should determine whether it can inexpensively implement some basic debtor profiling tasks using its current automated system. This could include using the automated system to screen whether a person or business was previously delinquent, or whether or not an account was resolved satisfactorily or needed additional enforcement action such as a lien or levy. Second, DOR needs to consider debtor profiling when planning its future automated, more modern collections system. The current DOR automated collections system is limited in its debtor profiling capabilities and other more sophisticated collection tasks.

Table of Contents

Page

Introduction and Background 1

Finding I: Better Use of Existing Enforcement Tools and Adoption of New Collection Methods Could Enable DOR to Collect Millions More in Delinquent Taxes 5

Only a Few Severely Delinquent Taxpayers Subject to Enforcement Action 5

Inconsistent Application of Levies May Leave Millions Uncollected 5

Failure to Follow Lien Guidelines Leaves Tax Debts Unsecured 8

Payment Agreement Noncompliance Results in Uncollected Tax Debts 11

Recommendations 14

Finding II: Increased Staff Could Result in Collection of an Estimated $6.6 Million in Additional Delinquent Tax Debts 15

Delinquent Tax Collections Not Keeping Pace with Increasing Number of Accounts 15

Table of Contents (con't)

Page

Finding II: (con't)

Additional Staff Needed to Address the Increasing Number of Collection Accounts 18

Recommendation 20

Finding III: DOR Could Enhance Delinquent Tax Collection by Using Other State Agencies' Databases 21

Nearly $4 Million Owed by State Employees and Vendors 21

Many State Employees and Vendors Are Not Actively Paying Off Their Delinquent Taxes 23

Match-Off Programs Feasible and Used in Arizona and Other States 24

Recommendations 26

Finding IV: Debtor Profiling Could Improve the Effectiveness of DOR's Collection Program 27

Debtor Profiling Increasingly Used by Private and Public Collections Agencies 27

Table of Contents (con't)

Page

Finding IV: (con't)

DOR Should Consider Using Debtor Information to Better Manage Its Delinquent Tax Accounts 28

Recommendation 29

Other Pertinent Information 31

Agency Response

Figure

Figure 1 DOR Collection Accounts Total Year-End Balance Due vs. Dollars Collected Fiscal Years 1989 through 1995 16

Table

Table 1 Delinquent Taxes of State Employees and Vendors as of April 1, 1995 22

INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Revenue (DOR), Collections Section, 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 third in a series of four audits of the Department.

Organization

The Collections Section is one of five sections within DOR's Compliance Division. In addition to the Collections Section, other sections include Individual Income Tax Audit, Corporate Income Tax Audit, Transaction Privilege, Use and Severance Tax Audit, and Contested Audit Resolution. The Compliance Division is the largest division in the Department with 592 of 1,245 total full-time equivalent (FTE) employees. Due to the Division's size and varied responsibilities, DOR's audit function was reviewed separately and will be addressed in a separate report.

In fiscal year 1995, the Collections Section was appropriated approximately $5.7 million of General Fund monies for section operations. The Section has grown slightly over the last several years, increasing from 201 FTEs in fiscal year 1988 to 235 in fiscal year 1996. In fiscal year 1995, the Section collected $129,463,796 in delinquent tax revenues.

Mission and Responsibilities

The mission of the Collections Section is to "secure the payment of delinquent taxes and returns through efficient and impartial enforcement to minimize lost revenues and promote voluntary compliance with Arizona's tax laws." The responsibilities of the five units within the section are summarized below.

- **Office Collections (96 FTEs)** — This unit collects delinquent taxes from individuals and businesses who fail to pay monies owed to the State, even after receiving a series of billing and past due notices. Office Collections is comprised primarily of collectors, who are responsible for making telephone contact with debtors to either collect monies due or set up a payment schedule. Unit staff may file liens, levies, and subpoenas to enforce collection of delinquent taxes.

- **Field Collections (48 FTEs)** — The Field Collections unit handles sensitive and difficult cases that have not been resolved through Office Collections efforts. The unit is staffed

with more experienced collectors. In addition to performing duties similar to office collectors (such as making telephone contact with debtors and filing liens, levies, and subpoenas), these collectors can conduct field investigations of complex tax cases and may seize property to satisfy tax liabilities.

- **Special Collections (24 FTEs)** — Special Collections coordinates functions that are outside of the office and field collections mainstream. The unit is made up of collectors and clerical staff. Among its varied duties, Special Collections handles bankruptcy accounts; responds to legislative, executive, and Attorney General inquiries; monitors the outside collections contractor; and applies debtors' tax refunds against past liabilities.

- **Support Services (61 FTEs)** — Clerical staff are responsible for assisting the Office, Field, and Special Collections units by processing collections correspondence, locating debtors without a current address or phone number, and processing liens, levies, and subpoenas.

- **Administration (6 FTEs)** — This unit is responsible for providing management support to each of the units within the Collections Section.

1988 Report Follow-up and Update

As part of our current audit, we reviewed concerns identified in our 1988 performance audit of the DOR Collections Function (Auditor General Report 88-6) and found:[1]

- **1988 Finding/Recommendation:** We reported that DOR could increase its phone collections revenues by at least $5 million annually through the use of an autodialing enhancement to its automated collections system. At the time of this audit, collectors manually dialed each account's phone number and waited to determine if the call would be answered. We recommended that DOR request from the Legislature an appropriation for the purchase of an autodialing system and an automated financial statement package.

  Follow-Up: DOR's request for an autodialing system was approved by the Legislature in fiscal year 1990. The autodial system contributed significantly to the success of DOR's collection efforts. Revenues generated by the Office Collections Unit increased $14.5 million in the year following implementation of the autodial system, an automated call distribution system, and modifications to DOR's automated collection system. In addition, delinquent tax revenues generated by Office Collections staff have continued to be at least $17.5 million higher than fiscal year 1990 levels in fiscal years 1992 through 1995.

---

(1) We first reviewed DOR's delinquent tax collection function in 1985 (Auditor General Report 85-8). Follow-up concerning findings and recommendations from this report was included in our 1988 audit.

- **1988 Finding/Recommendation:** DOR's phone collectors made calls only between 8 a.m. and 5 p.m. on Monday through Friday. We recommended that DOR extend its phone collections hours and schedule staff to work into the early evening and on Saturday morning in order to improve its telephone contact rate.

  Follow-Up: After our report was issued, DOR began calling delinquent taxpayers between 8 a.m. and 8 p.m. on weekdays and 8 a.m. to 12 noon on Saturdays. Currently, DOR has 20 collectors working in the early evenings and 10 working on Saturday mornings. In addition to extending the hours in which collectors can attempt to contact delinquent taxpayers, DOR management believes this effort has led to expanded customer service and increased callbacks during regular business hours.

- **1988 Finding/Recommendation:** DOR could collect additional revenue by more aggressively pursuing currently unlocated accounts (skip-tracing). At the time, DOR had committed only 2 FTEs to resolving these accounts and completed fewer than 5,000 skip-traces annually. We made several recommendations in the skip-tracing area. Most importantly,it was recommended that DOR devote more staffing resources to its skip-tracing function. In addition, it was recommended that DOR develop, when possible, automated skip-tracing procedures to replace those performed manually. Finally, a recommendation was made that DOR consider using private vendors to assist in locating delinquent accounts.

  Follow-Up: A skip-tracing unit was formed in late 1988 and currently has 14 FTEs. For the past 3 years, DOR has averaged over 37,000 successful skip-traces annually. Currently, there are a number of automated procedures in use, including on-line access to information from the Motor Vehicles Division (MVD), the Department of Economic Security (DES), the Corporation Commission, and the Internal Revenue Service (IRS). Contrary to our recommendation, DOR does not use private vendors to assist in locating delinquent accounts. DOR found that it is more cost-effective for DOR to perform skip-tracing internally at this time.

- **1988 Finding/Recommendation:** DOR could improve supervision and training to increase collector productivity and compliance with collection guidelines. We recommended that DOR require collection supervisors to increase their review of collector performance and take corrective action when deficient performance is noted. Specifically, supervisors should monitor and review collector productivity, adherence to DOR guidelines, and use of proper phone collection techniques.

  Follow-Up: A formalized two-step monthly review process was established in 1989 to measure adherence to guidelines and proper phone collection techniques. Reviews include periodic monitoring of collector phone calls and examination of account records. Supervisors meet with collectors each month to discuss their performance. The current review, however, found significant noncompliance with some collections guidelines. Managers also need to increase their oversight to ensure collectors comply with guidelines (see Finding I, pages 5 through 14).

- **1988 Finding/Recommendation:** DOR provided neither formal training concerning proper telephone collection techniques nor consistent on-the-job training. It was recommended that DOR include telephone collection techniques in its new collector training program instruction. In addition, on-the-job training should be consistent for all staff.

  Follow-Up: Telephone techniques training began in 1988 and has been updated since that time. All new employees take this class within their first four months of employment. In addition, a refresher course is offered for experienced collectors. A formalized on-the-job training program for field and office collections is also in effect and is conducted by trained facilitators.

Scope and Methodology

Audit work focused on how DOR can reduce the increasing gap between its delinquent tax account inventory and the amount of money actually collected. This report presents findings and recommendations in four areas:

- The need to strengthen delinquent tax collection enforcement.
- The need to increase staff in the Field Collections Unit to address increasing collector caseloads.
- The need to utilize database match-offs to improve taxpayer compliance.
- The need to use debtor information to customize debt collection efforts.

This analysis utilized a variety of methods, including extensive interviews with representatives from private collections firms and tax collection agencies in other states. To assess DOR's success and use of available enforcement tools, 200 levy files and 120 lien files out of those issued in June 1994 were randomly sampled. In addition, a comprehensive review of 120 cases that entered collections in fiscal year 1993 was performed. A comparison was also made between computerized data from DOR and the Arizona Department of Administration (DOA) to assess state employees' and vendors' tax compliance.

This audit was conducted in accordance with government auditing standards.

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

FINDING I

BETTER USE OF EXISTING ENFORCEMENT TOOLS AND ADOPTION OF NEW COLLECTION METHODS COULD ENABLE DOR TO COLLECT MILLIONS MORE IN DELINQUENT TAXES

DOR can more effectively utilize its delinquent account enforcement options, and adopt innovative collections techniques successfully used in some other states. Because DOR collectors have not followed levy guidelines in many cases, as much as $2.6 million in collections revenues remain uncollected. In addition, untimely filing of liens has left millions of dollars in state tax debt unprotected, leaving the State susceptible to large losses should debtors liquidate assets. Finally, reducing the number of defaulted payment agreements through the use of new collection methods could increase the amount collected from tax debt by millions annually.

Only a Few Severely Delinquent Taxpayers Subject to Enforcement Action

DOR's enforcement powers are only used on a relatively small number of businesses and individuals who refuse to pay taxes voluntarily. Ninety-five percent of revenues received by DOR (excluding property taxes) are paid voluntarily. Those who do not pay on time generally receive a series of three to ten billing notices prior to being assigned to the Collections Section, depending on the amount of the debt. Even after debtors enter the collections process, they are typically mailed additional letters, attempts at phone contact are made, and they are encouraged to make payment arrangements. Therefore, severely delinquent debtors are given multiple opportunities to comply before enforcement action is considered. In these cases, enforcement action is necessary to resolve the debt. Appropriate use of enforcement also encourages voluntary compliance with tax laws. According to the federal Internal Revenue Service (IRS), "the knowledge that enforcement is possible and does happen stimulates all taxpayers to comply with the law."

Inconsistent Application of Levies May Leave Millions Uncollected

A substantial amount of potential tax revenue may be left uncollected each year due to noncompliance with levy guidelines. Most levies were not issued according to DOR

guidelines. Failure to consistently follow levy guidelines and file levies in a timely manner may result in as much as $2.6 million going uncollected annually. To improve adherence with DOR requirements, the Department should strengthen its oversight of collector actions. In addition, DOR should also take steps to ensure that required levy source checks are completed prior to attempting multiple bank (mass) levies. Finally, DOR should also consider automating the levy issuance process when a new automated collection system is acquired.

Levies recover revenue when voluntary efforts fail — DOR uses levies to recover delinquent taxes when voluntary compliance efforts have proved unsuccessful. A levy is the seizure of taxpayers' liquid assets in the possession of employers and financial institutions to satisfy an unpaid tax debt. DOR is entitled to receive proceeds from a taxpayer's paycheck, minus deductions for self and dependents, to offset liabilities. Guidelines authorize collectors to issue levies when debtors have been found to be uncooperative, have broken agreements to pay monies owed, or are in jeopardy situations, such as an impending bankruptcy.[1]

If collectors cannot identify a debtor's bank account or place of employment, they may issue a multiple bank (mass) levy to two or more banks within the debtor's area of residence or business in an attempt to locate an active bank account. When issuing mass bank levies, collectors must also have reviewed Arizona Department of Economic Security (DES) employment records and credit bureau reports within the last 90 days and 6 months, respectively. This should be done prior to the levy to determine if a specific bank or employer levy source is available.

Levy guidelines seldom followed — DOR collectors often do not follow Department guidelines when filing levies. A statistically valid sample of 200 accounts levied by DOR in June 1994 revealed that collectors followed guidelines in slightly less than 25 percent of the cases examined. In 43 percent of all cases, DOR staff waited an excessive length of time to file the levies. In these cases DOR collectors did not file a first levy for a median of 110 days after the accounts were eligible for enforcement action. The remaining levies reviewed (32.5 percent) were done before all requirements for issuing a levy were met. The most frequent requirement not met (46 of 65 cases) involved mass bank levies that were issued without either the required DES search or credit bureau check. The case examples below illustrate the effects of collectors not complying with levy guidelines.

- A debtor entered the collections process in June 1991 owing $413 in delinquent income tax. Collectors first contacted the debtor in July 1991 and a payment agreement was established. The debtor broke his promise to pay after making just one installment. Collectors contacted the debtor again in November of 1991 and authorized a second

---

(1) DOR guidelines authorize collectors to classify debtors as uncooperative when they have failed to respond to a final demand letter and at least two telephone messages, or indicated during telephone or field contact that they will not cooperate to resolve the account. The guidelines also authorize immediate levy action when debtors break a promise to pay all, or a portion, of the amount owed after providing at least a five-day grace period.

payment agreement, which was also broken. Over the next two-and-a-half years, the debtor was allowed to enter into eight additional payment agreements, breaking promises to pay each time. DOR did not place a levy on the account until June 1994, three years after it entered the collections process. Although the bank levy yielded only $16, the debtor paid the remaining liability shortly after enforcement action was taken.

- A business debtor with a long history of making tax payments and filing returns late entered collections in March 1994. The debtor's liability quickly grew to $3,822. The debtor agreed to pay the balance in full in April 1994 and collectors advised that a levy would be issued if the payment was not received. However, although full payment was not received, no levy was ever issued, even though a potential bank levy source was recorded in the file and a 1989 levy was successful in resolving a previous delinquency. The account, with a remaining balance of $1,435, was still open at the time of review in May 1995, more than a year after entering the collection process.

$2.6 million may be lost annually — Failure to follow DOR levy guidelines may result in lost revenue totaling as much as $2.6 million annually. As part of the review of a statistically valid sample of 200 accounts levied in June 1994, the effectiveness of levies done according to Department guidelines was compared with those done without following the guidelines. Levies done according to the standards were much more successful in capturing the monies owed than those in which Department guidelines were not followed. Specifically the analysis showed that 29 percent of the cases in which guidelines were followed captured all monies owed the State, while only 13 percent of the cases done without adhering to the guidelines captured the delinquent taxes. When guidelines were followed, levies brought in an estimated $236 per account. In contrast, levies issued when guidelines were not followed brought in an estimated $136 per account. DOR issued a total of 32,649 levies in fiscal year 1994. If DOR had followed the guidelines in these cases, as much as $2.6 million more in delinquent taxes could have been collected.

Improvements to levy function needed — DOR could improve the effectiveness of levies in the short term by strengthening management oversight and in the long term by automating the levy determination process. To address widespread noncompliance with levy guidelines, DOR needs to take steps to improve oversight of collector actions. Supervisors need to more closely monitor collection accounts to ensure that levies are issued in a timely manner. Collection supervisors are responsible for periodically reviewing collection accounts to assess staff compliance with DOR guidelines. However, as noted above, these efforts failed to either spot or correct compliance problems. DOR management agrees that improved oversight is needed and believes that additional supervisory positions must be allocated to improve the span of control. The Department should evaluate existing supervisory oversight and assess 1) whether adequate improvements can be made with available resources or 2) additional supervisory positions are needed.

DOR can also improve the effectiveness of the levies it issues by taking steps to ensure that all levy source checks are performed prior to issuing mass levies. Mass levies are sent out to two or more banks within a geographical area when DOR has not identified a specific levy source for debtors. The Department has increasingly used mass bank levies in recent years. In fiscal year 1989, mass levies accounted for only 12 percent of the 18,480 total bank levies. By fiscal year 1994, nearly 57 percent of the 16,089 bank levies filed by the Department were mass levies. According to agency officials, the use of mass levies has increased in an attempt to take a stronger enforcement stance. However, although mass levies should be done only after a credit bureau check and DES employment search are completed, they are often performed without these steps being taken to identify potential wage or bank levy sources. This adds unnecessary processing costs to financial institutions and to DOR's levy unit. Financial institutions must research and respond to all DOR levy requests, even when the debtor has no account with the bank. In addition, DOR's levy unit must produce levy documents for as many as six banks when mass levies are requested.

Automating levy issuance is a long-term solution to DOR's noncompliance problem. Acquiring a new automated collection system, as discussed in the Other Pertinent Information section (see pages 31 through 32), would enable DOR to ensure that levies are done according to guidelines by programming the system to automatically route accounts to the appropriate staff when levy requirements are met. Since the early 1980s, the California Franchise Tax Board has used a collections system that issues both wage and bank levies automatically. The system, recently upgraded, allows California to resolve approximately 80 percent of its delinquent income tax accounts prior to collector action.

Failure to Follow Lien Guidelines Leaves Tax Debts Unsecured

Collector noncompliance with lien guidelines frequently leaves tax debts unsecured. Although liens are an important tool to protect the State's interest in delinquent tax cases and leverage compliance with tax requirements, liens often are not filed in accordance with DOR policies. As a result, millions of dollars in potential state revenue may be left unsecured each year. Improving management oversight, automating lien issuance, and reducing the predetermined level for issuing liens would better protect the State's financial interests.

A.R.S. §§42-1821 through 42-1822 authorize DOR to file liens whenever delinquent taxes are owed the State. DOR can file property liens with the county recorder in each of Arizona's 15 counties and the Arizona Office of the Secretary of State to secure tax liabilities. Since liens are attached to real property, debtors are unable to buy, sell, or borrow against property within the county until the lien is resolved. In addition, a lien filed with the Secretary of State limits businesses from financing receivables, inventory, or equipment because lenders would not be able to ensure that they would be repaid if the business defaults.

Department guidelines require liens to be filed on accounts with balances of $750 or more if the debtors have not made arrangements to pay the balance in full within 30 days for business accounts or 90 days for individual income tax accounts. DOR guidelines authorize collectors to place liens on accounts with balances between $100 and $750 after obtaining supervisory approval.

Lien guidelines not followed consistently — Collectors often do not file liens according to DOR guidelines. We reviewed a statistically valid sample of 120 lien cases issued in June 1994 and found that many were filed well after the lien guidelines had been met. Specifically, our analysis showed that in 40 of the 120 cases (33 percent), liens were issued late. Liens were not filed on these accounts for a median of 155 days after they became eligible for this enforcement action. Liens issued on business tax accounts were more likely to be filed late than those on individual income tax accounts. In nearly half of the 60 business tax cases we examined, liens were not issued as soon as the guidelines allow. The following case example illustrates the effect of DOR's failure to adhere to lien guidelines.

- A business debtor entered collections in February 1992 with a liability of $2,960. Although collectors left five messages for the taxpayer, the taxpayer did not respond. During this time, the debtor's tax liability increased to $5,929. Collectors finally reached the debtor in June 1992. Although the debtor agreed to pay the balance in full in July 1992, no payment was received and the liability increased further to $7,443. Collectors contacted the debtor to advise that a lien would be filed. However, collectors again allowed the taxpayer to set up a payment agreement and no lien was filed. This promise to pay was also broken. A lien was not filed on the account until February 1993. As a result, this state tax debt was left unsecured for one year.

Millions of dollars left unsecured — Untimely lien issuance leaves millions of dollars in debts unprotected each year. As mentioned above, in the 40 cases in which liens were filed late, liens were not requested for a median of 155 days after they were eligible for enforcement action. The median dollar value of the liens filed in these cases was $2,541. Based on the sample results, we estimate that late filing of liens in fiscal year 1994 resulted in a total of approximately $19 million being unsecured for at least a portion of the year.[1] It is critical that DOR file liens as soon as possible because debtors may owe money to multiple creditors. If the taxpayer begins to liquidate real assets (e.g. property or capital equipment), only those

---

(1) The estimated dollar value of tax debts left unsecured for a portion of the year was determined by extrapolating the results of our statistically significant sample, which found that 33 percent of the liens were left unsecured. The median value of the tax debt owed was $2,541. Thirty-three percent of the total lien population was 7,504 liens. This number of liens times the $2,541 median tax debt owed equals approximately $19 million in tax debt left unsecured for a portion of the year.

creditors with liens on the item or property will be entitled to receive proceeds from the sale. Therefore, filing a lien protects the State even if the taxpayers default on promises to pay their debts and begin to sell their assets.

Changes needed to improve lien process — DOR could better protect the State's financial interests by improving management oversight, automating lien issuance, and reducing the minimum dollar amount for issuing liens without supervisory approval. Current efforts to monitor collector compliance with lien guidelines are inadequate. As previously mentioned, liens were filed late in one-third of the reviewed accounts. This high level of noncompliance occurred despite the fact that collectors are rated on their compliance with lien guidelines and noncompliance with these guidelines is considered by the Department to be a "serious error." As with levies, DOR management agrees that management oversight can be improved and suggests that additional supervisory personnel are needed.

Automating the lien function would improve consistency in the application of lien guidelines. As discussed in the Other Pertinent Information section of the report (see pages 31 through 32), DOR's current automated collection system lacks the capacity to determine when lien requirements have been met and automatically route accounts to the appropriate staff for action. New systems are available that can be programmed to make lien determinations and perform necessary routing. Automation of lien determination has been accomplished in several other states. Virginia automatically generates liens 75 days after accounts enter collections. The California Franchise Tax Board has an automated collection system that will automatically file liens if the debtor fails to resolve the liability with a full payment or approved agreement. Maryland has had an automatic feature for liens on its income tax collection system since May 1994. After 180 days in the collections process, Maryland's system automatically files a lien on every account over $500. A Maryland official stated that automating the lien function has been effective in encouraging payment and, in turn, closing accounts. This feature has also added uniformity to its collection efforts. Prior to automating its lien function, Maryland relied on individual collector discretion in interpreting filing guidelines. As DOR considers acquisition of a new automated collection system, it should ensure that the system has the capacity to automate lien determination.

The Department should also consider lowering the minimum dollar amount for issuing liens to better protect the State's interest in delinquent tax cases. As mentioned above, DOR guidelines require collectors to obtain supervisory approval before filing liens on accounts with balances less than $750. DOR seldom issues liens when account balances are below this level. Four states surveyed and DES have lower requirements for filing liens that range from $100 to $500.[1] For example, DES' Unemployment Insurance Tax Section routinely liens all accounts over $100.[2] Reducing the lien threshold to $500 could result in securing as many as 10,000 debts valued at $6.1 million.

---

(1) These states are Florida, Illinois, Maryland and Texas.

(2) DES is responsible for administering the state unemployment tax collection program for Arizona.

Reducing the lien threshold will, however, impact DOR's budget. The fees charged to file liens with the counties and Secretary of State range from $3 to $7. In addition, it typically costs the Department $3 to have liens released. Although A.R.S. §42.137.01 provides the Departments with authority to recover these costs from the taxpayers, any monies recovered go to the General Fund. Therefore, DOR pays these fees from its budget. If more liens are issued, DOR will need additional funding to cover the cost.

Payment Agreement Noncompliance Results in Uncollected Tax Debts

In order to encourage voluntary compliance and reduce defaults that lead to enforcement action, DOR could improve its payment agreement process. Although DOR relies heavily on payment agreements to collect tax liabilities, these agreements are frequently broken by taxpayers, with millions of dollars in potential tax revenue left uncollected. In addition, even when debtors have had a history of breaking promises, collectors often continue to allow new agreements to be made. The Department could minimize the payment agreement default rate and collect millions more annually by requiring automatic withdrawal for those with bank accounts and accepting credit cards for payment of smaller tax debts.

The Department frequently uses payment agreements as a tool to collect delinquent taxes. Debtors entering the collections process are generally given the opportunity to establish payment agreements with DOR to resolve their tax liability. At any time, a substantial number of debtors are on payment agreements. For instance, in March 1995 approximately 26,500 collections accounts were on payment agreements. In total, these accounts were valued at nearly $39 million.

Few taxpayers comply with payment agreements — Delinquent taxpayers on payment agreements often break their promises to pay taxes owed the State, resulting in millions of dollars in tax liabilities uncollected.[1] In reviewing a judgmental sample of cases entering collections in fiscal year 1993, it was found that approximately 50 percent of agreements made by debtors were broken before the balance was paid in full. A statistically valid sample of cases with liens filed in June 1994 was also reviewed and it was found that approximately 80 percent of all promises were broken.

Even when promises are broken, DOR frequently allows taxpayers to establish subsequent payment agreements. Of the 43 cases with payment agreements in our fiscal year 1993 sample, 22 were set up on a second agreement and of those, 11 had 3 or more payment agreements. One taxpayer was allowed to make 12 separate payment agreements while in collections. In contrast, three states that we surveyed took enforcement action if a taxpayer broke two payment agreements. Two states allowed only one broken promise before

---

(1) DOR considers a promise broken if: (a) less than 90 percent of the payment due is received; (b) the payment is received 12 to 18 days after the due date depending on the tax type; and (c) a new liability enters the collection process.

enforcement.[1] Our research shows that those with multiple broken promises are less likely to pay off their tax liability in full, indicating that the fewer promises broken, the greater the percentage paid of what is owed.

Many broken promises result in less revenue collected — The high default rate on payment agreements entered into by delinquent taxpayers leaves a substantial amount of potential revenue uncollected, and prolongs the collection process. As mentioned above, in March 1995 approximately 26,500 accounts, with a total value of nearly $39 million, were on payment agreements with the Department. Although it is difficult to determine the amount of money that went uncollected because of broken promises (due to variation in the length of payment agreements and when during the course of agreements promises are broken), it is clear that millions of dollars are left uncollected. The case example below illustrates the effect of broken promises on payment agreement effectiveness.

- A business debtor entered the collection process in January 1992 owing $195 in sales tax. Collectors first contacted the debtor in February 1992 and an agreement was made to pay the liability in full. The payment was not received when due. The taxpayer was set up on four additional payment agreements between March and August 1992. Promises to pay were broken in each instance. Further tax liabilities were incurred by the debtor throughout this period, and by September 1992 the balance due increased to $10,190. The debtor made a string of sporadic payments, reducing his liability to $1,254 in April 1993. However, the liability then increased because the debtor did not submit payment when returns were filed. DOR continued to set up payment agreements with the debtor and no levies were attempted until August 1993, when a bank levy brought in $2,965. This account was still active at the time of our review, with an unpaid balance of $19,375.

Installment agreements are broken primarily because payment is voluntary and agreements are long-term. The voluntary nature of payment agreements leads to a high broken promise rate. Under DOR's current system debtors are responsible for sending in a check with their payment each month, rather than having payments deducted automatically from their bank account. In addition, our review of payment agreement data showed that agreements with longer terms were more likely to be broken than those with shorter terms. DOR staff recently examined a sample of 289 Office Collection accounts on payment agreements. Their research indicates that in 59 percent of these cases, payment agreements exceeded a year in length. In addition, 26 percent of the cases were for longer than three years. The DOR study concluded that the lengths of many payment agreements are "far outside the realm of reasonableness."

---

[1] Maryland, Minnesota, and Virginia gave two chances; Illinois and Texas gave only one chance.

Steps needed to reduce the broken promise rate — Compliance with payment agreements could be improved in a variety of ways, including:

- **Requiring automatic withdrawal** — Compliance with payment agreements could be improved significantly by mandating use of automatic withdrawal for those with bank accounts. Automatic withdrawal payments are received directly from banking institutions without taxpayer involvement. The use of automatic withdrawal is common in private sector installment agreements. Many mortgage, automobile, and student loan payments are made in this way. To address voluntary compliance problems, the Minnesota Department of Revenue initiated an automatic withdrawal program for payment agreements in 1993. After 15 months Minnesota found that 65 percent of those with automatic withdrawal had paid in full, while only 18 percent of taxpayers on voluntary payment agreements had paid in full. In addition to a dramatic increase in the compliance rate, Minnesota officials indicated that the automatic withdrawal program also has reduced administrative and clerical work because fewer checks must be processed and less correspondence with the taxpayer is needed.

- **Monitoring payment agreement length** — Improved management oversight is needed to ensure that payment agreement lengths are reasonable. DOR's typical payment agreement standard timeframe is 12 months or less. However, DOR now allows payment agreements up to three years in length for some debts under $5,000. In practice, payment agreements often have even longer terms. DOR management should more closely monitor payment agreements to ensure that the number of installments and the installment amounts are appropriate.

- **Allowing credit card payments could enhance collections** — Accepting credit cards for smaller tax debts would enable DOR to reduce reliance on payment agreements and increase dollars collected. DOR currently does not accept credit cards for any tax payments. The Federation of Tax Administrators has identified 12 states that accept credit cards for tax payments. Ten of these states accept credit cards for delinquent tax payments. The Governmental Finance Officers Association (GFOA) supports use of credit cards for state and local government tax payments. The GFOA reports that accepting credit cards accelerates payment and reduces the cost of collecting monies owed. Oregon has accepted credit cards as a method of payment for delinquent taxes since 1990. An Oregon administrator stated that approximately 1,000 taxpayers utilized this service during fiscal year 1994, allowing the collection of about $1 million in revenues annually. In Arizona, if credit card payments were permitted for liabilities up to $1,000, many accounts could be paid in full rather than being placed on an installment agreement. As of July 1995 there were 71,971 collections accounts assigned to the Office and Field Collections Units, valued at approximately $22.9 million, with balances less than $1,000.

  DOR would need additional statutory authority to absorb credit card fees for delinquent tax debts. Banks processing credit card transactions charge a fee of 1.5 to 3 percent for credit card use. Credit card companies, such as Visa and MasterCard, generally do not

allow those accepting the credit card to pass the fee along to the cardholder. Six states have obtained authority to pay the fee, which, at 1.5 to 3 percent, is generally less than DOR's cost of collecting delinquent tax accounts.

RECOMMENDATIONS

1. The Legislature should consider providing DOR statutory authority to allow the Department to deduct applicable credit card fees from the tax payments received.

2. The Department should take the following steps to increase the effectiveness of enforcement tools.

   - Improve management oversight of collector compliance with DOR lien and levy guidelines.

   - Ensure that required levy source searches are done prior to issuing mass levies.

   - Reduce the dollar threshold required to file liens without supervisory approval.

3. As the Department considers acquiring a new automated collections system, it should ensure that systems under consideration are capable of automating levy and lien determination.

4. The Department should require automatic withdrawal for delinquent taxpayer payment agreements, where available.

5. The Department should monitor payment agreements to ensure that the number of installments and the installment amounts are reasonable.

FINDING II

INCREASED STAFF COULD RESULT IN COLLECTION OF AN ESTIMATED $6.6 MILLION IN ADDITIONAL DELINQUENT TAX DEBTS

The Arizona Department of Revenue needs to increase collection staff to address the growing number of delinquent tax accounts and increase the tax debts it collects. Although the total dollar value of delinquent tax accounts entering the collection process has increased 93 percent since fiscal year 1989, amounts collected each year from these debts have experienced little or no growth during this period. The number of delinquent accounts assigned to field collectors has become excessive and needs to be addressed. Increasing staff in the Field Collections Unit would reduce the number of accounts assigned to collectors and could enable DOR to increase the tax debts it collects by an estimated $6.6 million annually.

Delinquent Tax Collections Not Keeping Pace with Increasing Number of Accounts

Increasing numbers of delinquent accounts have outpaced DOR's ability to collect them. DOR's workable delinquent tax account balance that could feasibly be collected has risen from $106 million to $205 million in the past six fiscal years. In contrast, the amount of delinquent taxes collected has plateaued at approximately $125 million over the same time period. Much of the growth in delinquent tax accounts is attributable to DOR's increase in audits performed during the early 1990s. The growing number of delinquent tax accounts has resulted in backlogs in the later stages of the Department's collections process and aging accounts that are more difficult to collect.

Delinquent accounts increasing while collections remains the same — DOR's collections efforts have not kept up with its increasing delinquent account numbers or balance. Over the past six fiscal years, the delinquent account balance that could feasibly be collected has grown 93 percent.[1] DOR's collections efforts, however, have plateaued at $125 million annually over those same six fiscal years. Historically, DOR has been able to collect a larger

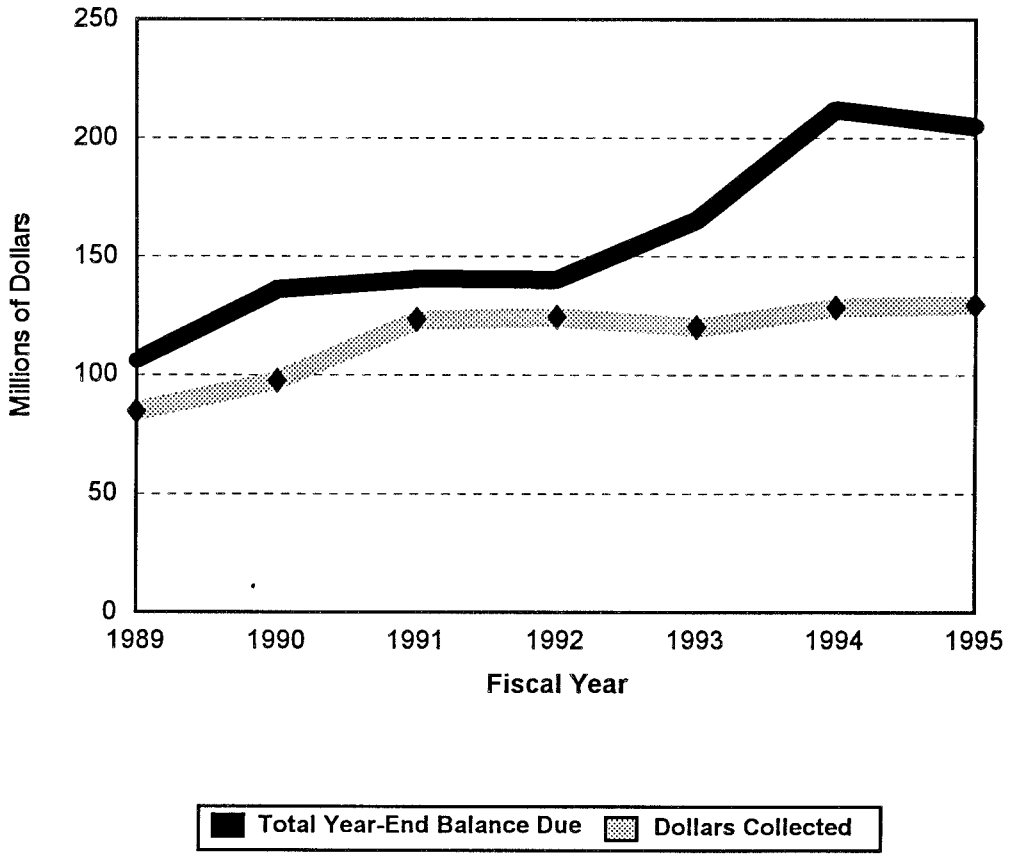
---

(1) Bankruptcy accounts were excluded because DOR has no authority to collect them. DOR determined "uncollectible" accounts were also excluded because the Department cannot collect them for various reasons, such as no addresses, etc.

percentage of delinquent taxes owed. However, this percentage has declined as the number of accounts has increased. Figure 1 illustrates the increase in DOR's delinquent account balance versus the dollars collected from these debts since fiscal year 1989.

Figure 1

DOR Collection Accounts[a]
Total Year-End Balance Due vs. Dollars Collected
Fiscal Years 1989 through 1995



---

[a] These figures exclude bankruptcy and DOR-determined "uncollectible" accounts.

Source: DOR delinquent account year-end balance and collection data for fiscal years 1989 through 1995.

Several reasons for increasing numbers of delinquent tax accounts — The growing number of delinquent tax accounts can be attributed to a variety of factors. First, an increase in the number of audits conducted by the Department has led to a significant increase in delinquent tax accounts. The number of audits rose from 28,354 in fiscal year 1989 to 116,796 in fiscal year 1994, a 312 percent increase. Audit cases not resolved voluntarily or through negotiations are eventually forwarded to the Collections Section. Audit-related receivables now account for 38 percent of all receivables in the collection process. Second, Arizona's rapid population growth has also contributed to the growing number of delinquent tax accounts. Between fiscal years 1989 and 1995 Arizona's population increased approximately 16 percent. Finally, DOR management also cites the transient nature of Arizona's population as a reason for the increase in accounts entering the Collections Section. According to DOR, accounts for individuals living in Arizona only seasonally or staying a short time are difficult to pursue and collect. During the same period, the Collections Section has experienced relatively little staffing growth to absorb the extra cases.

Backlog and aging accounts — The increase in delinquent accounts has caused backlogs in the later steps in the collections process and has resulted in accounts aging with little or no action taken.

Much of the growth in delinquent accounts has particularly impacted workloads in the later stages of the collection process: field collections; accounts referred to a private collection agency; and those deemed uncollectible.[1] In fiscal year 1991 these three areas accounted for only 19 percent of all cases in the collections process. In fiscal year 1995, these same areas comprised 41 percent of all accounts assigned to the Collections Section. During this period, Field Collections accounts have risen from 7,762 to 20,398, accounts referred to a private collection agency grew from 10,701 to 27,880, and uncollectible accounts increased from 8,343 to 21,199. Increases in the number of delinquent accounts in the Office Collections Unit, which is responsible for initial collection efforts for accounts entering the section, has not been as dramatic since accounts unresolved by collectors in this unit can be forwarded to Field Collections or a private collection agency. In addition, the Office Collections Unit has added 28 staff in the last 5 years and in 1994, due to a backlog in Office Collections, management transferred 10,000 accounts to Field Collections and a private collection agency.

---

(1) Accounts entering the collection process generally are assigned first to the Office Collections Unit. Collectors attempt to make telephone contact to request payment or set up an installment agreement. In instances when taxpayers refuse to pay or fail to adhere to the terms of payment agreements, collectors attempt to enforce collection through use of liens and levies. Accounts unresolved by Office Collections Unit staff are typically forwarded to either DOR's Field Collections Unit or a private collection agency for further collection efforts. The Field Collections Unit receives in-state accounts with balances due of $200 or more. Field collectors may file liens and levies, make field visits, and conduct seizures in their efforts to resolve tax debts. A private collection agency attempts to collect in-state tax debts less than $200 and most out-of-state accounts. If field or private collectors cannot resolve tax delinquencies, accounts may be deemed uncollectible.

Because DOR has been unable to keep pace with delinquent tax accounts entering the collection process, accounts have aged and, as a result, can become more difficult to collect. Many of the accounts currently assigned to the Collections Section have been in the collection process for years. For instance, nearly half of all delinquent tax accounts have receivables with money due from 1991 or before. As accounts age, the possibility of collecting the tax debts decreases because taxpayers may move and be difficult to locate, or companies may go out of business.

Additional Staff Needed to Address the Increasing Number of Collection Accounts

DOR needs to increase its collection staff to address the growing number of delinquent tax accounts. Collector caseloads in the Field Collections Unit have become excessive while staffing levels and the dollars collected have not increased. Adding 18 new field collector positions would reduce caseloads to a more manageable level, and could enable the Collections Section to increase the money collected from tax debts by $6.6 million annually.

Collector caseloads unmanageable — Field collectors cannot adequately manage current caseloads. Since fiscal year 1990, the number of accounts assigned to the Field Collections Unit has grown 272 percent. Due to the unit's rising caseload, the average number of delinquent accounts per collector has increased from 183 to 583 between fiscal years 1990 to 1995. Furthermore, many collectors have caseloads well above these levels. As of April 1995, 11 of the 35 collectors had caseloads greater than 750, and 2 of these had caseloads in excess of 900. In contrast, the IRS assigns no more than 109 cases to experienced field personnel. Other states also assign fewer cases to field collectors. A survey of five other states found that their field collector caseloads ranged from 100 to 300 cases.[1]

Excessive caseloads make it difficult for field collectors to take the actions needed to resolve many of their assigned cases. Due to excessive caseloads, agency management has instructed its field collectors to focus their efforts on accounts with balances greater than $5,000. These cases comprise only 18 percent of all accounts assigned to the Field Collections Unit. However, on average, field collectors have 96 accounts over $5,000 assigned to them. According to supervisors and staff, there is little time to work on accounts with balances less than $5,000. If accounts cannot be resolved in field collections they may eventually be classified as uncollectible, contributing to the significant growth in the uncollectible inventory.

Collection and staffing levels stagnant — Field collection staffing has remained constant at 35 collectors for the past 5 years and tax debts collected by the unit have plateaued at approximately $21 million. Although the number of cases assigned to the Field Collections

---

[1] States surveyed involved Colorado, Florida, Illinois, Texas, and Virginia.

Unit nearly tripled between fiscal years 1990 and 1995, no new staff were added during this period.

Recognizing that field collector caseloads are excessive, DOR recently created several new field collector positions. During the course of our audit, the agency authorized a transfer of six Individual Income Tax Audit Section positions to the Field Collections Unit. As a result, the average field collector caseload dropped from 583 to 498 at the start of fiscal year 1996.

Staff increases needed — Although DOR has taken steps to begin addressing excessive field collector caseloads, further staffing increases are needed. Agency management believes each field collector can manage approximately 300 to 350 cases. An additional 18 field collectors are needed to lower the average caseload from 498 to approximately 350.[1] This would raise the total number of field collectors to 59. The estimated cost of adding collection staff is approximately $870,000 in the first year.[2] However, the cost of adding new field collectors may be reduced if positions can be transferred from other areas within the Department. As mentioned above, DOR recently transferred positions from the Individual Income Tax Audit Section to the Field Collections Unit. Further interagency transfers to the Collections Section may be feasible, which could reduce the cost of adding collection staff.

Adding field collector positions would enable DOR to significantly increase the amount of revenue collected by its Field Collections Unit. In fiscal year 1994, the median amount generated by field collectors over the entire year was $667,000. The minimum amount collected by a field collector during this period was $413,000. If each of the new collectors generated $413,000, they could collect a total of $7.4 million annually. This would result in an estimated net collection of $6.6 million annually.

DOR needs to utilize a staged approach to implement staffing changes. According to DOR management, the addition of 18 field collectors, 2 supervisors, and 2 support staff will impact its collections processes. For example, office collectors will apply for field collector positions and field collectors will apply for the supervisor positions. In addition, if DOR is able to provide these additional positions internally through downsizing another functional area rather than through a budget request, additional personnel changes would occur. Based on the need to better ensure that collectors are following lien and levy guidelines, DOR expressed concern that their numbers of collectors-per-supervisor ratio may be too high. We did not, however, conduct audit work to determine this. Because of these factors, DOR will need to plan for and execute the changes needed to add more collectors over a period of time to ensure minimal disruption of operations.

---

(1) We recommend adding only 18 collectors because we believe that recommendations for improved enforcement in Finding I will decrease the number of cases referred to the Field Collections Unit, and further reduce collector caseloads.

(2) This estimate includes 18 field collectors, 2 supervisors, and 2 support staff. Employee-related expenditures of 24 percent and travel costs have also been accounted for. In addition, the estimate includes a one-time cost of $99,000 for needed office equipment.

RECOMMENDATION

To address excessive field collector caseloads, DOR should request additional funding for 18 additional field collectors. However, the Department may be able to minimize the cost of new collector positions by transferring positions from other areas within DOR to the Collections Section.

FINDING III

DOR CAN ENHANCE DELINQUENT TAX COLLECTION BY USING OTHER STATE AGENCIES' DATABASES

A taxpayer entered DOR's collection process in September 1990 with a balance due of $1,169. Unaware that the taxpayer has been a state employee since October 1991, the Department has never levied the employee's state wages. In addition, by the time of our review in June 1995, the employee's tax debt had increased to $2,400.

Using information maintained by other state agencies could help DOR collect more delinquent taxes. A comparison of DOR's collections database with two of the Department of Administration (DOA) payments databases identified over 1,300 state employees and almost 600 vendors who owe nearly $4 million in delinquent taxes. Many of these delinquent taxpayers were not actively paying off their debts. Database comparisons such as the DOR/DOA example can help DOR identify income sources that can then be used to either pay off the debt or establish a payment agreement. DOR concurs and has proposed expanding the concept to compare its database with a Department of Economic Security (DES) employer database that contains information on employees of the majority of Arizona's employers.

Nearly $4 Million Owed by State Employees and Vendors

A comparison of two DOA databases with DOR's found that state employees and vendors on state contract owed nearly $4 million in delinquent taxes. We obtained Department of Administration employee and vendor data on electronic tape and performed a match-off with DOR's delinquent account records by comparing the lists of state employees and vendors to the lists of delinquent taxpayers.

State employees owe considerable back taxes — State employees owe a significant amount of delinquent taxes, as shown in Table 1 on page 22. Analysis showed that 1,355 state employees owed $1,906,963 in income and business taxes. Although 531 of the delinquencies were less than $200, 354 employees had tax debts of $1,000 or more. Many of these accounts have been in the collection process for years. Thirty-seven percent of these accounts, totaling over $1.2 million, date from 1992 or earlier. This case example illustrates difficulties DOR

may have collecting delinquent taxes without having other information provided by a database match-off.

- In July of 1994, DOR attempted to levy the wages of a taxpayer who owed over $2,000 in delinquent taxes and whose account had been assigned to the Collections Section since 1990. However, the taxpayer was no longer employed at the company to which the levy was mailed. At the time of this levy, the taxpayer was employed by the State, and had been for over three months. The employee's state wages have never been levied.

Table 1

Delinquent Taxes of State Employees and Vendors as of April 1, 1995

	State Employees	State Vendors
Total Dollars Owed	$1,906,963	$1,933,898
Total Number of Accounts	1,355	589
Dollar Range:		
$200 or less	531	195
Between $200 and $1,000	470	170
$1,000 or more	354	224
Date Entering the Collection Process:		
Before 1990	131	36
Between 1990 and 1993	373	115
1993 and later	851	438

Source: Auditor General staff comparison of DOA employee and vendor data with DOR tax delinquency data.

Vendors with state contracts have considerable tax delinquencies — Many vendors doing business with the State also have tax debts. We chose a nine-month period from July 1994 through March 1995, and identified those vendors who received payments while they had tax delinquencies. Five-hundred and eighty-nine vendors owe a total of $1,933,898 in delinquent taxes. The largest single debt is $150,181. Two-hundred and twenty-four vendors each owe $1,000 or more, and their total delinquency is $1,835,419. A number of these cases have also been in collections for several years. One-hundred and fifty-one vendor accounts, valued at $921,415, entered Collections before 1993. The following case example illustrates

that vendors could be paying off delinquent taxes with monies received from the State if DOR were aware of this income source.

- A taxpayer has entered the collection system numerous times with balances exceeding $10,000. As of August 1995, the account had a delinquent balance of $66,555. During the nine-month period of the sample match-off, this taxpayer received $111,080 in state payments, none of which were applied toward the liability. A match-off program would have enabled DOR to levy sufficient payments to resolve the account, with no need for collector intervention.

Many State Employees and Vendors Are Not Actively Paying Off Their Delinquent Taxes

Because DOR does not currently obtain the information available through match-offs on state employees and vendors with delinquent taxes, many of them are not actively paying off the taxes they owe. Our match-off found that only 49 percent of state employees, (excluding those in bankruptcy), with delinquent income or business taxes had a payment arrangement with DOR. In addition, DOR had placed 47 state employee delinquent accounts in the "uncollectible" file. The most common reason for this was that these taxpayers could not be located.[1] Further, 152 employee accounts were sent to a private collections agency because they could not be resolved through internal departmental efforts. If DOR was aware that delinquent taxpayers and businesses were receiving state monies, it could have accessed those monies through levies or payment agreements rather than assigning the accounts to private collectors, who charge a 22 percent collections fee.

Five-hundred eighty-nine delinquent vendors received payments from the State in the sample nine-month period covered by our investigation. Of these vendors, just 105 — less than 22 percent of those not in bankruptcy — had made payment agreements with DOR. Twenty-five accounts were classified as uncollectible, and 27 had been sent to outside collections agencies.[2]

Because DOR does not perform match-offs with other state information, it may be unaware that state payments have been made that could be used to offset delinquent tax debts. For example:

---

(1) Accounts may also be classified as uncollectible in hardship situations, when debtors are incarcerated, or when corporations become defunct.

(2) DOR indicated that many of these state employees and vendor accounts are being worked on even if a payment agreement does not exist.

- A delinquent taxpayer began working for the Arizona Department of Corrections in September 1994, at that time owing a balance of $12,280. The account has been in collection since January 1987. The balance has since grown to over $13,000.

- DOR assigned the account of a firm owing $12,900 to a collection agency in August 1994, claiming there were no levy sources and that they had exhausted their collection options. However, the State paid $133,345 to the firm between July 1994 and March 1995, including $106,516 after the account was sent to a collection agency.

It appears that the State could collect much of the delinquent tax amounts owed by state employees and vendors either through direct payment, payment agreements, or account levies. Income from state employment or contracting for services is a sure source for collections. In the nine-month period covered by our test match-off, over $500,000 was paid by state agencies to tax delinquent vendors that could possibly have been recovered by DOR for payment of tax debts. In addition, many delinquent taxpayers owe relatively small amounts that could either be paid in full or subject to a payment agreement. For example, 39 percent of the state employees with delinquent taxes owe $200 or less and 35 percent owe between $200 and $1,000. The average state employee debt is $1,407. The average for state vendors is $3,283. One-hundred and ninety-five vendors owe $200 or less and 170 owe between $200 and $1,000.

Match-Off Programs Feasible and Used in Arizona and Other States

Match-off programs can aid in collecting delinquent taxes. DOR currently operates two very successful match-off programs, and at least two other states run successful programs. Creating a state employee and vendor match-off program would not be costly. DOR has proposed expanding the concept beyond just state employees and vendors to all public and private sector employees, except federal employees, by matching its information against the Department of Economic Security's (DES) employer database.

DOR's current programs — DOR currently operates two successful debt offset programs. The Department has a program to check whether those scheduled to receive tax refunds owe delinquent taxes. Before tax refunds are issued, they are automatically offset against any outstanding tax liabilities from previous years. In fiscal year 1994, $3,680,828 in delinquent income taxes was recouped from 24,357 individual taxpayers while 177 accounts yielded $382,973 in corporate tax. In a second program, DOR checks whether those receiving the refunds owe money to other state agencies that have filed claims with the Department. Eleven agencies participate in this DOR program. For example, the University of Arizona submits

claims to DOR for those owing for housing, student loans, and parking. The Department of Economic Security submits claims for individuals owing child support. In the first half of 1995, this program produced $3,540,000 in payments against 25,124 matches.[1]

Other states — Some other states have successful match-off programs. The Illinois Department of Revenue's program has been operating since 1986. It covers both individual and business tax delinquencies and generates up to $1 million per year. The match-off in Maryland has yielded $15,000,000 in its 12-year existence. In addition to the obvious benefits, in each case, officials believe that the existence of the programs also has considerable incentive effects in encouraging taxpayers to settle their tax liabilities.

Programs not expensive — Setting up and operating an automated match-off program for state employees and vendors would not be expensive. The debt set-off program currently administered by DOR cost $110,400 to operate in fiscal year 1994. DOR officials estimate that the programming changes necessary to implement a match-off could be accomplished in 282 to 424 hours of programmer/analyst time, costing between $10,000 and $15,000.

DOR proposes an expanded program — DOR has proposed expanding the match-off concept beyond state employees and vendors to include all employees in the State, except those working for the federal government. DOR is proposing matching its database against a DES employer database. The DES employer database lists all non-federal Arizona employers and employees that are liable for unemployment tax. Therefore, this match-off would identify wage levy sources for the majority of persons working in Arizona that owe delinquent taxes. This would include state employees, state university employees, other public sector employees, and private sector employees. In a letter dated October 30, 1995, DOR requested that DES, begin performing the programming necessary for a monthly match-off. DES has estimated that the effort will cost $4,820 for development and testing and $142 for monthly production costs. For state vendors, DOR agrees that a DOA/DOR match-off is needed and reports that it is currently working with DOA to implement such a program.

---

(1) In 1990, DOR also conducted a pilot match-off program with the Arizona Department of Transportation and the Arizona Department of Corrections. DOR staff manually reviewed records provided by these agencies to identify vendors with delinquent sales tax returns or receivables. Although $415,733 was collected from vendors identified through these efforts, the program was discontinued in the first year because the manual nature of the program was labor intensive and management felt staff time could be better spent on other collection activities.

RECOMMENDATIONS

1. DOR should develop and implement a program to match payments made to state employees and vendors on state contracts with state tax liabilities to expedite the collection of tax delinquencies.

2. DOR should continue development and implementation of a program to identify wage levy sources by matching its delinquent tax information with the Department of Economic Security's unemployment tax database of employers and employees.

FINDING IV

DEBTOR PROFILING COULD IMPROVE THE EFFECTIVENESS OF DOR'S COLLECTION PROGRAM

DOR could use debtor information to better manage its delinquent tax accounts. Information about debtors is increasingly being utilized by public and private collection firms in determining the steps needed to resolve account delinquencies. DOR should consider using debtor information in the future to enhance the effectiveness of its collection program.

Debtor Profiling Increasingly Used by Private and Public Collections Agencies

Information concerning debtor characteristics is now being used to customize collection efforts. Data regarding debtor characteristics can be utilized to assess the risk associated with accounts and determine what actions are necessary to resolve delinquencies. Debtor profiling is being done by private and public debt collection operations, as well as banking and mortgage institutions that issue loans.

Debtor profiling — Information concerning debtors can be used to improve the effectiveness of collection efforts. Debtor profiles, also referred to as behavioral collection scoring, can be developed to assess the likelihood of collection or the "risk" associated with an account. These models incorporate variables such as the number of previous delinquencies, actions taken to resolve previous delinquencies, amount and age of the receivable, and the debtor's taxable income.

Profiling provides fairer, more equitable treatment of taxpayers, taking strong collection action only against those avoiding payment, not those attempting to comply. For example, a taxpayer with no previous history of delinquency owing a relatively small amount may be sent a number of automated billings attempting to resolve the account before phone contact is attempted. In contrast, an account that has been in collections previously and has required enforcement actions to force resolution may not receive any automated letters or phone contact but would simply be forwarded for swift and appropriate enforcement action.

Collection agencies utilizing debtor information — Private and public collection operations are increasingly using information concerning debtor characteristics to customize collection efforts. The federal General Accounting Office (GAO) reports that debtor profiling is becoming more common in private firms. Modeling techniques also are being used by banks

and mortgage companies to determine whether loans should be approved and what actions should be taken when loan payments are past due. Interviews with private firms indicate that customizing the collection process has led to both increased revenue collection and improved customer relations. The GAO noted similar findings in a 1993 report.

Public tax collection agencies are also beginning to use debtor profiling. For instance, in response to a recommendation from the GAO, the IRS has initiated a pilot behavior scoring program in its western region with the intention of eventually implementing these models nationwide. Some states also are beginning to better utilize debtor information and customize collection efforts. For instance, the Minnesota Department of Revenue distinguishes between cooperative and uncooperative business taxpayers based on current and past responses to collection efforts. In addition, the California Franchise Tax Board implemented behavior scoring technology to prioritize all accounts entering its collection system.

DOR Should Consider Using Debtor Information to Better Manage Its Delinquent Tax Accounts

Debtor profiling would enhance DOR's ability to effectively manage collection accounts. In most cases, the Department does not use information concerning debtors to tailor collection efforts. Debtor profiling could be accomplished through acquisition of available software or reprogramming of DOR's existing automated collection system.

DOR does not utilize debtor profiling for most accounts — Generally, the Department uses the same process for all delinquent accounts without considering how likely it is the taxpayer will pay his debt. DOR typically utilizes a three-stage collection process using automated letters, followed by phone contact, then field collection. Except for cases involving large delinquencies, an account generally follows this same process until the case is resolved or deemed uncollectible. In fiscal year 1994, 57.1 percent of accounts entering collections had been in the collections process at least once before. No steps are taken to classify these accounts differently from first-time offenders. The following case example illustrates how debtor profiling could have assisted DOR in more quickly resolving a delinquent account.[1]

- A taxpayer entered the automated collection system on July 8, 1991. The taxpayer made three promises to pay the liability and defaulted on each one. Over the course of 14 months, 8 phone attempts, 1 field call, and 3 levies were necessary to finally resolve the

(1) Accounts within the collection process, however, are prioritized by both dollar amount and receivable age. In addition, large accounts are selected out for immediate action. Further, DOR may also deviate from its typical collections process if other factors arise.

account on September 23, 1992. On July 13, 1993, the taxpayer became delinquent for a second time and was placed in phone collections, in accordance with agency policy. DOR then made 15 phone attempts before taking enforcement action, 1 year after the entry date. During this period the taxpayer again broke many promises to pay and the liability increased from $228 to $2,740. This case was finally resolved in May of 1995, almost two years after it entered collections. This account could have been forwarded directly to the field collections unit based on its prior history. This would have accelerated resolution and saved a significant amount of collector time.

Debtor profiling is feasible — The Department should consider using debtor profiling to enhance its collection efforts. Software is available to develop and evaluate debtor profiling models. The California Franchise Tax Board utilizes this software to facilitate its account ranking and has stated it improved collector efficiency by directing resources where they are most effective.

DOR should approach debtor profiling in two ways. First, DOR should determine whether it can inexpensively implement some basic debtor profiling tasks using its current automated system, such as whether a person or business was delinquent previously, or whether or not an account was resolved satisfactorily or needed additional enforcement action such as a lien or levy. Second, DOR needs to take into account the need for debtor profiling as it considers a more modern automated collections system in the future. The current automated collections system is limited in its capabilities to do debtor profiling and other more sophisticated collection tasks. Other pertinent information regarding the benefits of a more modern automated collections system is presented on page 31.

RECOMMENDATION

1. DOR should consider utilizing debtor profiling in the future to customize debt collection efforts.

OTHER PERTINENT INFORMATION

During the course of our audit, we reviewed the adequacy of DOR's current automated collection system and compiled information on more innovative systems.

Current Automation Outdated

The Department's automated collection system is outdated and limited in its performance. A 1985 performance audit conducted by our Office identified the need for an automated collection system. A system was purchased later that year and was implemented in 1987. This automated collection system replaced a manual process and significantly improved collection levels. However, the system's capabilities are limited, especially given the increasing number of accounts now in the collections inventory. Computer technology in the collections area has progressed rapidly in the eight years since DOR implemented its current system. Problems with system effectiveness include:

- **Lack of reliable information** — The Department's automated collection system does not provide necessary information to make informed management decisions and monitor accounts. For example, the percentage of cases collected in full cannot be tracked. The system also does not provide information concerning success of liens, levies, and payment agreements. On numerous occasions during our audit work, basic statistics related to collection performance could not be generated by DOR's automated collections system.

- **Dependence upon collector intervention** — DOR's current automated system relies heavily on collector intervention. Manual decisions must be made by DOR collection staff before action can be taken on an account. Liens and/or levies cannot be performed without a collector viewing an account and determining this action is appropriate. Accounts cannot be moved between worklists without a collector instigating the change. In contrast, the Arizona Department of Economic Security, Unemployment Tax Division, is able to automatically route accounts under $100 to a separate worklist. These accounts are then sent automated letters to encourage payment. Actions are more timely since the computer locates these accounts rather than a collector.

Technology has been developed since DOR implemented its current system, which is designed specifically for public sector collection operations. Benefits of these systems include:

- **Increased debtor information** — To customize collection procedures, detailed information must be maintained concerning the characteristics of debtors and previous collection actions taken by the Department. Advanced automated systems track and summarize

enforcement actions taken on each account, the success of these enforcement actions, and the number of payment agreements entered into and kept.

- **Automatic routing of accounts** — Accounts can be moved by programming Department criteria into the system, therefore bypassing collector intervention. Management would have the ability to define criteria for an account to be moved within the system. For example, accounts within specified dollar and age ranges could be searched out and instantly routed to a worklist for a specific action. Management would have this capability through their personal computers. In contrast, management currently needs to request mainframe programming.

- **Consistent use of enforcement tools** — For accounts meeting Department enforcement criteria, typically liens and/or levies, action could take place without collector intervention and with greater consistency. Swifter action could be taken on seriously delinquent accounts.

Other state collection operations are in the process of implementing these types of systems to increase the effectiveness of their collection efforts. Cost estimates for these innovative collection systems range from $350,000 to $900,000. However, results of these new systems are not yet available.

Agency Response

ARIZONA DEPARTMENT OF REVENUE

1600 WEST MONROE - PHOENIX, ARIZONA 85007-2650

FIFE SYMINGTON
GOVERNOR

HAROLD SCOTT
DIRECTOR

December 13, 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 received the final report of your performance audit of the Department of Revenue (DOR), Collections Section. Following is our response to that audit report in the form of an overview, general comments on some of the findings, and specific responses to each recommendation:

OVERVIEW

The Department has a significant conceptual disagreement with the Auditor General regarding the approach that should be taken to the collection of delinquent taxes. Throughout the Collection report, a repeating theme is that the Department's determination on enforcement action should be governed by an established set of rules which are then essentially followed automatically. The Department disagrees with this approach.

The Department believes that each taxpayer's situation is different and collectors need the flexibility to customize their collection strategy to each individual situation. The fact that a taxpayer is in some form of economic distress does not change the fact that he is our customer and that the collection strategy utilized should be the one that maximizes collections while minimizing the intrusion into, and effect upon, the taxpayer's life.

Therefore the Department views its guidelines as exactly that -- a standard against which the collectors should measure their individualized collection strategies. When liens and levies are not issued at the time set forth in the guidelines, that does not by itself constitute a failure to follow the guidelines; instead, it may represent an appropriately considered

decision by the revenue officer using his professional judgment that a different approach is more appropriate. That is why they are "guidelines", not rules.

In most cases (in fact, all that are specifically cited in the report), it is not a question of "lost" revenues, but an issue of the timing of collections. Collecting the delinquent amounts, albeit at a later date with interest, has resulted in the State being made whole without making the taxpayer who has fallen upon hard times a victim of an unthinking, unfeeling, rule bound bureaucracy.

It is also worth noting that the Department averages approximately $1,000,000 per year in collections for each collector position. This average collection is generated despite a terribly high attrition rate (and therefore vacancy rate) for collectors driven by an uncompetitive salary structure and the difficult nature of the job. Given a six month training cycle, and the impact on senior collectors who must provide the on the job training, the single biggest gain, at the lowest overall cost, could be achieved by raising the salaries of the collectors thereby reducing attrition and providing the state with experienced collectors.

The Department's various efforts to continually improve and refine its collection processes are bearing fruit. The downward trend since 1994 in collectable accounts receivable shown in the chart on page 16 of the report has continued. The collectable accounts receivable balance, as of the end of November, has dropped to $200.7 million.

FINDING I

Only those delinquent taxpayers who require enforcement action are and should be subjected to enforcement action. While the statement that only a few severely delinquent taxpayers are subjected to enforcement action may be factually correct, it is misleading. The Department believes, as do most public and private collections programs, in staging its collections efforts. Most taxpayers will, and do, pay their liabilities without forcing the Department to take enforcement actions. As you note, only those who fail to do so should, under normal circumstances, be subjected to enforcement actions. Subjecting the State's citizenry to unnecessary levy and lien action would be an abuse of Departmental authority.

The alleged inconsistent application of levies will not leave millions uncollected. The Department agrees that for a period of time in late 1994 and early 1995 some collectors did not issue levies in some cases where such action was appropriate. The Department identified this problem and took steps to remedy it. In FYE95, the Collections Section issued levies on 52,597 accounts, a 61% increase over FYE94. However, the suggestion

that **as much as** [emphasis added by DOR] $2.6 million may have gone uncollected annually is unsupported by the data.

The cost effectiveness of an automated levy system is suspect. The Department agrees that a computer system that could use expert type systems to evaluate the likelihood that a levy is appropriate at a given time would be helpful to the Department and its collection process since it would assist the collector and his supervisor in making the final decision. However, it must be recognized that the introduction of such a system would necessitate a major capital expenditure since the Department's current automated collection system is incapable of implementing such a system. The Department has been unable to identify any vendor or set of vendors who could provide such a system at the costs set forth in the report ($350,000 to $900,000). The Department's experience leads it to conclude that such a system, if purchased today, would cost well in excess of one million dollars. Whether the gain from such a system would be worth the costs of purchasing and implementing it is a matter that must be carefully studied.

Payment agreements need to be carefully monitored, but more aggressive collection actions will not necessarily increase revenue to the state and may unnecessarily harm the taxpayers. The report states that millions of dollars went uncollected because of broken promises. As in several other places, that kind of statement is misleading. There are many reasons why a promise may be recorded as broken, some of which are circumstances beyond the control of the taxpayer. DOR collectors have the discretion to use their professional judgment and consider the circumstances in deciding whether to reset payment agreements or pursue forced collections. The goal is not to punish the taxpayer but to secure resolution of the tax debt in the fairest, least intrusive and burdensome manner possible.

Having said that, the Department does agree that in late 1994 and early 1995 some collectors were failing to take appropriate enforcement action when taxpayers failed to perform upon their payment agreement promises and meet their tax obligations, and the Department had already implemented new management policies to see that the collectors utilize their judgment to defer enforcement action only in appropriate circumstances. The management study referenced on page 12 was part of that self-initiated internal management review by the Collections section.

Recommendation 1. The Legislature should consider providing DOR statutory authority to allow the Department to deduct applicable credit card fees from the tax payments received.

The Department has been studying and planning to implement the use of credit cards in limited circumstances in future years. However, as in the case of automatic withdrawal

payments, the most troublesome accounts will be those of persons who are not credit worthy and do not have credit cards.

The Department believes that the Legislature should closely examine the impact of permitting the Department to absorb the credit card fees. Many credit cards grant the holders benefits deriving from the use of the card (frequent flyer miles, cash back, etc.) and under varying circumstances won't even charge interest if the account is paid promptly. The legislative change suggested by the report could induce many taxpayers to use the credit card in lieu of the payment they would normally make. The impact on the state of absorbing the fee in such cases could be substantial.

Recommendation 2. The Department should take the following steps to increase the effectiveness of enforcement tools.

- *Improve management oversight of collector compliance with DOR lien and levy guidelines.*
- *Ensure that required levy source searches are done prior to issuing mass levies.*
- *Reduce the dollar threshold required to file liens without supervisory approval.*

The Department believes it has already taken steps to improve management oversight of all aspects of collector compliance with DOR lien and levy guidelines, including the requirement for levy source searches prior to issuing mass levies, as evidenced by the internal collections study referenced in the report.

The Department will do a pilot test to determine if lowering the dollar threshold for liens is cost effective. If it proves to be cost effective, this may be addressed in future budget requests.

Recommendation 3. As the Department considers acquiring a new automated collections system, it should ensure that systems under consideration are capable of automating levy and lien determination.

When considering the acquisition of a new automated collections system, the Department will include this feature in the RFP. While the Department disagrees with the concept of automatically issuing a levy or lien irrespective of the unique facts and circumstances of an individual case, it does agree that automation could enhance the professional efforts of the collectors to structure the appropriate collection strategy for each taxpayer. The extensive system recommended by the Auditor General needs to be carefully studied given its cost. Meanwhile, the Department has been working for more than a year on a series of computer programs that will significantly increase the automated capacity of the

Department to issue and release liens and to reduce the costs associated with those actions.

Recommendation 4. The Department should require automatic withdrawal for delinquent taxpayer payment agreements, where available.

While the Department has no objection to implementing an electronic funds withdrawal program for taxpayers on payment agreements if it will generate greater compliance at less cost, it is worth noting that many delinquent taxpayers are not credit worthy and do not have bank accounts from which to make automatic withdrawals. Since such a program is necessarily limited to those taxpayers with bank accounts, they are a preselected group of delinquent taxpayers who are most likely to meet their tax obligations anyway. In addition, there will be costs associated with establishing such a program. The Department will pilot test this program and if it proves effective, will seek its implementation.

Recommendation 5. The Department should monitor payment agreements to ensure that the number of installments and the installment amounts are reasonable.

The Department will continue to monitor payment agreements to ensure they are reasonable. However, to the extent that the recommendation implies that payment agreement length should be restricted, the Department notes that the IRS is currently permitting individual taxpayers to enter into three year payment agreements and it would be extremely difficult to establish a significantly different standard given the imminent implementation of a nationally recognized program between the Department and the Southwest District of the IRS to place common delinquent taxpayers on a coordinated payment agreement for both agencies.

FINDING II

Recommendation. To address excessive field collector caseloads, DOR should request additional funding for 18 additional field collectors. However, the Department may be able to minimize the cost of new collector positions by transferring positions from other areas within DOR to the Collections Section.

The Department agrees that additional staff is needed, especially in field collections, to collect the delinquent taxes owed to the State. In recognition of the need for additional collectors and changes in compliance patterns of individual income tax filers, the Department had already designed and commenced implementation of a plan to convert

sixteen individual income tax audit positions into collector positions. Six of these were converted to field collector positions and the remaining ten to office collectors. While these sixteen positions have already improved the overall effort, the additional 18 field collector positions recommended by the Auditor General will have a very positive effect on reducing the field collector caseloads to a workable level. The Department is continuing to monitor and identify full time positions that could be better utilized in collections.

The Department's various efforts to continually improve and refine its collection processes are bearing fruit. The downward trend since 1994 in collectable accounts receivable shown in the chart on page 16 of the report has continued. The collectable accounts receivable balance, as of the end of November, has dropped to $200.7 million.

FINDING III

Recommendation 1. DOR should develop and implement a program to match payments made to state employees and vendors on state contracts with state tax liabilities to expedite the collection of tax delinquencies.

The Department agrees that automation of the process of matching employees to delinquencies would enhance collections. However, the Department believes that focusing attention on only state employees is a shortsighted effort. Instead, the Department is working with the state Department of Economic Security to implement a total automated matching program of all delinquent taxpayers against the DES employment tax records in order to identify potential wage levy sources. This program, when completed, will provide the Department with the matching capability for almost all waged employees, not just state employees.

The Department agrees that a vendor matching program with the Department of Administration is a good idea and has established a joint task force with the Department of Administration to implement such a program.

Recommendation 2. DOR should continue development and implementation of a program to identify wage levy sources by matching its delinquent tax information with the Department of Economic Security's unemployment tax database of employers and employees.

As indicated above, the Department is doing this.

FINDING IV

Recommendation 1. DOR should consider utilizing debtor profiling in the future to customize debt collection efforts.

Debtor profiling is a fairly new technology that has great promise but has not yet been successfully implemented in government tax agencies. The successful implementation of debtor profiling is dependent upon the quantity, quality and accessibility of debtor information. Furthermore, much of the debtor profiling being used in the private sector is aimed at the extension of credit rather than the collection of monies owed.

The Department would have a great deal of difficulty implementing debtor profiling with its current automated collection systems. The implementation of debtor profiling would depend upon not just purchasing and customizing a debtor profiling package but also upgrading the Department's current automated collection system to a new, more modern one capable of using such profiles and making additional changes to the Department's accounts receivable system and mainframe hardware.

The total cost of such a combined package would be substantial. Contrary to the implication in the report, California's Franchise Tax Board is implementing its debtor profiling system simultaneously with its implementation of a new automated collections system. In fact, California officials have indicated to DOR officials that they cannot determine at this time how much of their improvements are attributable to the new automated collections system and how much to debtor profiling. Given the necessary interrelationship between debtor profiling and the automated collection system it feeds and analyzes, the Department believes that it is more prudent to consider this functionality at the time it upgrades its automated collection system and will do so at that time.

OTHER PERTINENT INFORMATION

While not making a finding, nor a formal recommendation, the report notes that new and improved systems exist for automating collection activities. The Department agrees that the current system used by DOR is somewhat outdated and limited in what it can do given modern technology. However, the Department believes that the report dramatically understates the true costs of upgrading and makes no effort to quantify the benefits associated with such an effort. The Department will study this and, if it believes the benefits exceed the costs and provide an acceptable return rate, will approach the Legislature with the proposal.

The Department commends the Auditor General for recognizing and acknowledging that the current system is reaching the limits of its capacity and will ultimately have to be upgraded or replaced with newer technology. It is during that natural evolutionary transition to newer technology that many of the enhancements suggested can be appropriately addressed.

Sincerely,

Harold Scott

Harold Scott
Director