A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit

Department of Revenue—
Collections Division

OCTOBER • 2005
REPORT NO. 05 – 14

Debra K. Davenport
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.

The Joint Legislative Audit Committee

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

October 3, 2005

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Mr. Gale Garriott, Director
Arizona Department of Revenue

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Department of Revenue, Collections Division. This report is in response to a November 20, 2002, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Department agrees with all of the findings and plans to implement all of the recommendations.

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

This report will be released to the public on October 4, 2005.

Sincerely,

Debbie Davenport
Auditor General

Enclosure

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PROGRAM FACT SHEET

Department of Revenue
Collections Division

Services:

The Collections Division helps ensure that the State receives tax monies owed. The Division's collection functions are divided among three major sections:

- Office Collections—Office collectors generally handle the first step in the collections process and attempt account resolution through telephone and mail.
- Field Collections—Field collectors generally work on collections cases after collections efforts have been exhausted by office collections. Field collectors attempt account resolution via telephone and field contacts and can recommend that a case be written off.
- Bankruptcy and Litigation—Collectors assigned to this section are responsible for identifying cases that involve bankruptcy filings and following up on actions taken by the courts. Additionally, they handle a wide variety of other activities, including handling disputed accounts.

Facilities:

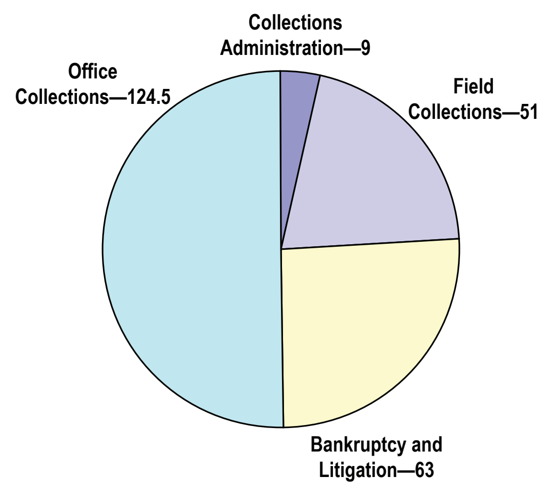
The Division's staff are located in three offices state-wide. Specifically, division staff are located in the agency headquarters, a state-owned building at 1600 West Monroe in Phoenix, and in a state-owned building complex at 400 West Congress in Tucson. Finally, Collections Division staff are also located in a privately owned facility at 3191 North Washington Street in Chandler, Arizona. The Division occupies 5,200 square feet of this private, 20,783-foot facility that the Department leases for $283,426 annually, plus operating costs.

Equipment:

The Division uses a Predictive Dialer System (PDS) and an Automatic Call Distribution (ACD) system, which has an Interactive Voice Response (IVR) module. The PDS is an inte-

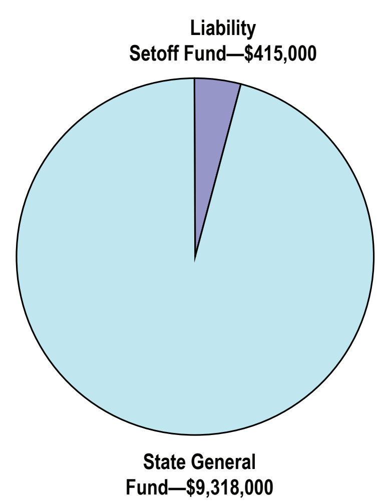
Program staffing:

247.5 FTEs, including 35 vacancies (as of January 2005)



Program revenue:

$9.73 million (fiscal year 2005, estimated)



grated outbound call collection system through which the collector works the accounts the system dials. The system also provides taxpayer information on the collector's computer and anticipates collector availability. The Automatic Call Distribution system is a system that manages and processes incoming phone calls. The ACD has an IVR module that provides automated responses for some basic collections questions, such as account balances. The Division also has a Simon board, which reflects information from both the PDS and the ACD, such as the number of incoming calls, outgoing calls, and hold and wait times. The Department pays the Department of Administration for use of these systems, which are shared with other state agencies.

In addition, the Department's field collectors are provided handheld computers. The 50 devices contain specific information on taxpayers' accounts including amounts owed, payments made, and prior collections history. This allows collectors to perform major job functions, such as initiating payment plans and logging case activity, while in the field. The Department paid approximately $500 for each device.

Mission:

To fairly and efficiently collect receivables and delinquent returns and to insure businesses are properly licensed/registered with the Department.

Program goals:

The Collections Division has adopted the Department's three goals:

1. To maximize the return on investment.
2. To maximize customer and stakeholder satisfaction.
3. To maximize employee satisfaction.

Adequacy of performance measures:

Although the Division's 18 performance measures appear to be generally appropriate and well-aligned with the three departmental goals, the Division should consider expanding its performance measures and ensure it has readily accessible data to monitor its performance. Currently, the Division has established a variety of performance measures including outcome, quality, and efficiency. To ensure that it can more effectively assess its performance, additional measures should be considered, such as those relating to collector caseloads, the age of collection cases, and the number of cases entering collections, as well as the number of cases and reasons for closures each year. Doing so will require that more data is readily accessible. Because of computer storage limitations on its outgoing system, the Division did not have key historical information readily available during this audit. The Division indicates that its new computer system, BRITS, is designed for better data retention and access. However, since BRITS is still being developed, the Division should identify the key performance data it needs and ensure that the BRITS system can readily provide this information.

Source: Auditor General staff analysis of unaudited financial schedules prepared by the Department of Revenue for the years ended or ending June 30, 2003 through 2005, the Department's 2004 annual report and strategic plan, the Department's organizational chart for the Collections Division, and other information provided by the Department.

SUMMARY

The Office of the Auditor General has conducted a performance audit of the Department of Revenue's Collections Division pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq and is one in a series of four reports on the Department. The other reports focus on the Audit Division, the Business Reengineering/Integrated Tax System (BRITS) project, and an analysis of the 12 statutory sunset factors.

The Collections Division helps ensure that the State receives tax monies owed. Although most tax revenues are paid voluntarily, sometimes individuals, corporations, or businesses do not pay their taxes and the Department, through its Collections Division, must take additional enforcement actions. The collections process begins only after a taxpayer has received at least one letter requesting payment and a final demand notice from the Department's accounts receivable system. Any amounts that are not paid through this accounts receivable process are forwarded on to the Collections Division for enforcement action. The Division has authority to take several different types of enforcement actions and several options for negotiating account resolution, such as working with delinquent taxpayers to establish payment plans and levying monies from a taxpayer's paycheck.

This audit focused on ways in which the Division might increase its productivity. The Division's annual collections of past-due taxes increased from approximately $137 million to approximately $242 million between fiscal years 2000 and 2004. Similarly, the number of collector positions within the Division also increased by nearly 80 percent. The average dollar amount collected per collector FTE (full-time equivalent position) was approximately $1.4 million in both fiscal years 2000 and 2004.

Division could improve collections by expanding matching programs (see pages 9 through 17)

The Division has taken several steps to improve its ability to help it find and seize the wages and bank accounts of taxpayers who have not paid their taxes, but additional steps could be taken. The Division has implemented automated processes to find and levy taxpayers' wages or bank accounts, and it also participates in a federal program under which delinquent taxpayers' federal tax refunds can be used to satisfy their Arizona tax debt. Nonetheless, several other opportunities remain:

- **Matching wage records**—The Department should consider expanding the number of accounts matched against Department of Economic Security (DES) unemployment insurance records and decreasing the amount of time that passes before an account that is matched against DES records is assigned to a collector for additional action. Additionally, the Division should consider requesting a legislative change so that it can match accounts against an additional DES database that contains more updated information than is currently matched. Finally, the Division should ensure that collectors are automatically notified when automated wage and bank account matches occur.

- **Matching bank records, other state records, and State Lottery payouts**—The Division should seek legislative authority to establish a matching program with Arizona banks. The Division already has a process in place under which banks in Arizona are asked on a case-by-case basis whether a particular taxpayer is an account holder, but this process is expensive for the banks and the Department and cumbersome to administer. A more efficient option would involve establishing a program similar to DES that requires Arizona banks to provide account information to DES for computer matches against child support enforcement data. If the Division were legislatively authorized to establish a similar program, more delinquent taxpayer bank accounts may be identified, and the burden on banks for responding to the Division's current case-by-case requests would be reduced.

  The Division should also continue to monitor a matching program under which the Division works with the Department of Administration to verify whether vendors receiving payments from the State owe any delinquent taxes. Finally, the Division should implement a matching program with the State Lottery, as already authorized by state statute. The Division has begun to work with the Lottery to establish such a program.

Division could improve automated collection tools (see pages 19 through 23)

To enhance collections, the Division has added some automated tools it can continue to improve:

- **Enhancing current debtor profiling efforts**—The Division is in the process of implementing debtor profiling—an approach designed to direct stronger collection actions against taxpayers who are more likely to try avoiding payment. The Division will need to periodically evaluate and revise, as necessary, this program to ensure that it is effective. For example, the Division currently does not consider an account's age as a part of determining the risk that it may not be paid, but may want to consider doing so in the future because older accounts may be more difficult to collect. Use of debtor profiling may also affect work patterns within the Division, making it important to evaluate and possibly adjust staff distribution.

- **Ensuring cases approaching the statute of limitations are reviewed**—Statute gives the Department 6 years from when a tax debt is identified to collect the debt. The Collections Division currently reviews some accounts before their expiration. However, it has not established a consistent time frame for reviewing cases before they expire and has not ensured that all tax types are encompassed in the review. Automation can help in this regard.

- **Building controls into the new computer system**—As more activities are converted to the Department's new computer system, the Division needs to ensure that automated controls are in place for key collection activities. This new computer system is being implemented as a part of the Business Reengineering/Integrated Tax System (BRITS) project.[1] The Division's outgoing computer system currently contains many automated controls that increase the likelihood that collectors follow division policy. As the Department converts more of its activities to the new computer system, the Division will need to ensure that appropriate controls are in place to encourage compliance with division policy.

Division should take steps to provide taxpayers additional options to pay debts (see pages 25 through 29)

The Division can encourage taxpayers to pay their tax debts by making it easier to do so. Auditors identified three potential approaches to improving payment options:

1 In August 2002, the State entered into a contract with Accenture, a global management consulting firm, to reengineer its core business processes and organizational structure, and implement an integrated tax system. With BRITS, all taxpayer data will be entered in and available through this one integrated system.

- **Accepting credit card payments**—As a part of the BRITS project, the Division is working toward accepting credit card payments from businesses and individuals who file returns, pay taxes on time, and owe past-due taxes. The Internal Revenue Service (IRS) and several states do so. However, the Department's current statutory authority appears to be directly tied to Web-based tax transactions. Taxpayers may prefer some other approach, such as using a mail-in form or paying in person. Therefore, the Division should seek a statutory change to allow credit card payments to be used for non-Web-based transactions.

- **Expanding the use of automatic withdrawals**—The Division should consider seeking statutory authority and developing the technical ability to accept automatic withdrawals from taxpayers, similar to practices used in other states and at the IRS. Use of automatic withdrawals, also known as electronic funds transfers (EFT), has the potential to reduce administrative costs and improve taxpayer compliance. An IRS representative who auditors interviewed indicated that the use of automatic withdrawals significantly reduces the default rate. Although the Department is already required by statute to accept EFT payments for businesses that paid $1 million or more in transaction privilege taxes during the prior year, and employers who had quarterly average withholding tax liability of $20,000 or more during the prior year, the Division does not have the statutory authority to collect automatic withdrawals for collection accounts that are on a payment plan.

- **Establishing payment plans by phone and Internet**—The Division should consider allowing delinquent taxpayers with a positive history of paying their tax obligation to set up payment plans through an automatic telephone or Web-based system. Auditors found examples of other states using such systems. For example, Virginia, which purchased an automated telephone system in 2001, reports that the system has been used to set up more than 47,000 payment plans totaling over $50 million. Such systems may encourage more taxpayers to pay, and the Division should assess the feasibility of establishing such a program.

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INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Department of Revenue's Collections Division pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq and is one in a series of four reports on the Department. The other reports focus on the Audit Division, Business Reengineering/Integrated Tax System (BRITS) project, and an analysis of the 12 statutory sunset factors.

Collections Division helps ensure State receives tax monies owed

The Collections Division is one of nine divisions within the Department.[1] The Department is responsible for licensing, processing, and collecting most taxes for the State of Arizona (see text box). In fiscal year 2004, the Department reports that it collected more than $9.8 billion in state and local revenues to pay for many public services, including education, health, and welfare.

The Collections Division helps ensure that the State receives tax monies owed. Although most tax revenues are paid voluntarily, sometimes individuals, corporations, or businesses do not pay their taxes, and the Department must take additional enforcement actions through its Collections Division. The Division's mission is to "*fairly and efficiently collect receivables and delinquent returns and to insure businesses are properly licensed/registered with the Department.*"

Arizona's Primary Tax Revenue Sources

- **Transaction privilege, use, and severance taxes**—A transaction privilege tax is imposed on a seller for doing business in the State. Because it is usually passed on to the customer, this tax is commonly referred to as a sales tax. Use tax is imposed on the purchase of personal property for which a transaction privilege tax was not paid, and severance tax is imposed on the business of mining metalliferous minerals and severing timber. Some of these taxes are collected for and distributed to Arizona's cities and counties.

- **Individual income taxes**—These are taxes imposed on individuals earning income in Arizona. Businesses or individuals are required to withhold Arizona income tax from employees' compensation and remit it to the State through the Department. Income tax revenues are shared with Arizona cities and towns.

- **Corporate income taxes**—These are taxes imposed on corporations earning income in Arizona and are shared with Arizona cities and towns.

1 The other divisions are Administrative Services, Audit, External Services and Special Projects, Information Technology, Processing Administration, Property Tax, Taxpayer Services, and Tax Policy and Research.

Collections process

Arizona statutes give the Department 6 years to collect tax debts or file suit.

The collections process begins only after a taxpayer has received at least one letter requesting payment and a final demand notice from the Department's accounts receivable system. Any amounts that are not paid through this accounts receivable process are forwarded onto the Collections Division. Per A.R.S. §42-2066, the Department has 6 years from when a tax debt is identified to collect the debt or file suit to recover the debt.

The Division has the authority to take several different types of enforcement actions, as well as several options for negotiating account resolution (see text box). Office

Enforcement Actions

- **Bank levy**—A seizure of a taxpayer's monies in possession of financial institutions to satisfy an unpaid tax debt.
- **Wage levy**—A seizure of the monies from a taxpayer's paycheck, less deductions for the taxpayer and their dependents.
- **Liens**—Liens are attached to real property, which can make it more difficult for debtors to buy, sell, or borrow against property until the lien is resolved. For example, the Division can file property liens with the county recorder in each of Arizona's 15 counties.
- **Seizures**—Seizing the individual's or business' real or personal property, which may include land, the business inventory, or the business in its entirety.

Account Resolution Options

- **Payment Plan**—Payment plans are negotiated when taxpayers are unable to resolve their tax debt in one payment. The taxpayer may be required to provide verbal or written financial statements, depending on the amount and terms of the plan.
- **Offer in Compromise**—Offers in compromise allow the taxpayer to settle their account for less than the amount due.
- **Write-off**—Write-off involves the case being deemed uncollectible due to taxpayer circumstance, such as lack of monies and terminal illness. Write-offs must be forwarded and approved by the Attorney General's Office.

Offset Program

- **Federal Refund Offset**—This offset allows for a taxpayer's federal refund to be paid directly to the State to satisfy outstanding tax debts.

collectors are generally the first division staff assigned to work with the taxpayer to reach account resolution. Specifically, office collectors contact the taxpayer by telephone and/or by mail. Office collectors can request liens or levies and negotiate payment plans. If an office collector is unable to reach account resolution, the case is generally forwarded to field collections. Field collectors use a combination of telephone and field contacts to attempt case resolution. Field collectors have the additional authority to recommend seizures, negotiate offers in compromise, and recommend that a case be written off as uncollectible.

Responsibilities and organization

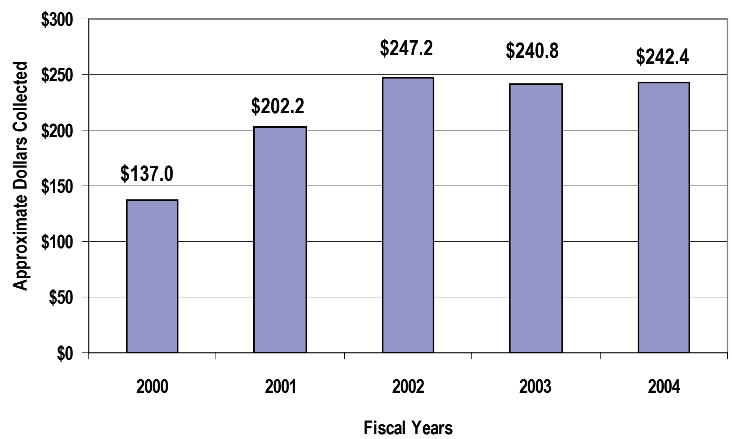
The Division's nearly 250 FTE are responsible for collecting past-due taxes. Over the past 5 years, the Division's collection amounts and staffing levels have both increased. Annual collections of past-due taxes rose from approximately $137 million in fiscal year 2000 to approximately $242 million in fiscal year 2004, according to division figures (see Figure 1). During the same period, the size of the Division's staff increased by almost 80 percent. Some of this staff increase was received for special initiatives. For example, the Division gained 24 FTE as part of a revenue-generating program.[1] Additionally, the average collected in fiscal year 2004, approximately $1.4 million per collector FTE, was virtually the same as it was in fiscal year 2000.

The Division's staff and dollars collected here increased by almost 80 percent during the last 4 fiscal years.

As of January 3, 2005, the Division had 247.5 FTE positions, of which 35 FTE were vacant. These staff and the collection functions they perform are divided among three major sections, as listed below:

- **Office Collections (124.5 FTE, 21 vacancies)**—Office collectors are responsible for the initial phase of case resolution and as shown in Figure 2, (see page 4), as of January 2004, were responsible for the majority of collection cases. The Office Collections section is responsible for answering incoming calls, making outgoing calls, and assisting taxpayers who come into the office. Office collectors work from the main office in Phoenix, as well as additional offices in Chandler and Tucson.

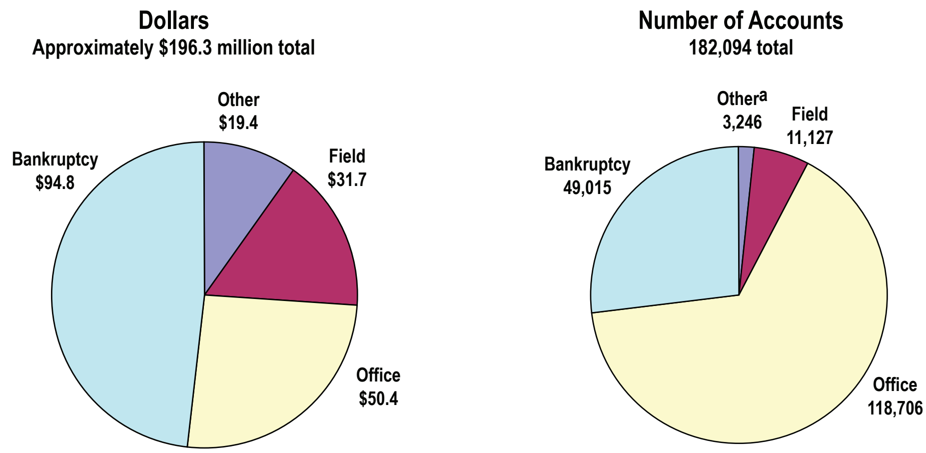
Figure 1: Past-Due Taxes Collected, in Millions
Years Ending June 30, 2000 through 2004
(Unaudited)



Source: Auditor General staff analysis of the Department's *Collections__historical__activity__10__yrs* report.

1 Laws 2003, 1st S.S., Ch. 1. The revenue-generating program expanded the Department's enforcement function by providing additional FTEs, to the Collections and Audit Divisions. The Department assigned 24 of these FTEs, to the Collections Division and anticipates that the new positions assigned to both divisions will generate an additional $53.2 million for the State General Fund each year.

Figure 2: Past-Due Tax Accounts Assigned to Collections Division
As of January 2, 2004
(Unaudited)



[a] The "Other" category comprises accounts assigned to the Attorney General's Office and the Penalty Review Unit in the Division of Taxpayer Services.

Source: Auditor General staff analysis of the Collection Division's inventory data from the Division's Computer Assisted Collections Systems as of January 2, 2004.

- Field Collections (51 FTEs, 6 vacancies)—Field collectors generally work on collections cases after collections efforts have been exhausted by office collections. The Field Collections section is staffed with more experienced collectors who are responsible for the more sensitive and/or complex cases. This section also oversees the debt set-off activities.[1] This section has fewer cases, as shown in Figure 2. The Field Collections section operates from the Division's three offices.

- Bankruptcy/Litigation (63 FTEs, 6 vacancies)—The Bankruptcy/Litigation section handles a variety of specific collection activities. First, at any time during the collections process when a taxpayer is identified as having a bankruptcy filing, the case is routed to the Bankruptcy/Litigation section. This section is responsible for identifying all cases that involve bankruptcy filings, ensuring that the appropriate claims are filed and following up on actions being taken by the bankruptcy court relative to these accounts. The section also refers cases to the Attorney General and processes offers-in-compromise. The litigation unit, which is part of the section, is responsible for all other nonmainstream collection activities, including handling disputed accounts, insufficient funds check

1 The debt set-off activities involve a match to ensure that those taxpayers scheduled to get a state refund do not owe money to other state agencies (for example, child support to the Department of Economic Security) and courts that have filed a claim with the Department.

collections, lien processing, and internal systems training. This section is located only at the Phoenix office.

The remaining nine FTEs include the division assistant director, and administrative, information technology, and training staff.

Division budget

During fiscal year 2005, the Department allocated approximately $9.5 million to the Collections Division for operations (see Table 1, page 6). Approximately 96 percent of these monies came from the State General Fund.

Scope and methodology

This audit focused on ways the Collections Division can improve its productivity, including following up on recommendations made in a 1995 Office of the Auditor General performance audit on the collections function (Auditor General Report No. 95-17). The current audit report presents three findings and associated recommendations:

- Although the Division has taken steps to improve its performance by adopting several automated matching programs to help it find and levy bank accounts and wages from taxpayers who have not paid their taxes, these programs can be improved. Specifically, the Division should consider improving the matching program that is used to identify wage levy sources and consider new matching opportunities with Arizona banks and the State Lottery.

- The Division can further enhance collections by improving some of its automated tools. Specifically, the Division should ensure that the debtor profiling program is periodically evaluated to ensure it is effective. The Division should also ensure that all cases approaching the statute of limitations are identified and reviewed. Finally, as more activities are converted to the new computer system, the Division needs to ensure that automated controls are in place for key collection activities such as liens, levies, and payment plans.

- The Division can further encourage taxpayers to pay their tax debts by making it easier to do so. Specifically, it should request the Legislature to broaden its statutory authority so that it can accept credit card payments for collection accounts and non-Web-based transactions, and allow taxpayers with delinquent tax debts to fulfill payment plans through automatic withdrawals, and it should

Table 1: Collections Division
Schedule of Revenues and Expenditures, in Thousands
Years Ended June 30, 2003, 2004, and 2005
(Unaudited)

	2003	2004	2005
Revenues:			
State General Fund	$7,790	$8,872	$9,134
Liability Set-off Fund[1]	371	379	361
Total revenue	$8,161	$9,251	$9,495
Expenditures:			
Personal services and employee related	$7,708	$8,760	$8,986
Professional and outside services	13	16	31
Travel	87	121	134
Other operating	281	335	342
Equipment	72	19	2
Total expenditures	$8,161	$9,251	$9,495

1 Amount is the Division's portion of Liability Set-off Fund monies used for administering the set-off program.

Source: Auditor General staff analysis of unaudited financial schedules prepared by the Department of Revenue for the years ended June 30, 2003, 2004, and 2005.

assess the feasibility of allowing low-risk taxpayers to set up payment plans through automatic telephone or Web-based systems.

Various methods were used to study the issues addressed in this audit. General methods used included interviews with department and division management and staff as well as information provided by the Federation of Tax Administrators. Auditors also reviewed Arizona Revised Statutes, the Code of Federal Regulations, Department of Revenue Tax Rulings, division policies and procedures, and goals, objectives, and performance measures.

In addition, the following specific methods were used:

- To determine whether prior audit recommendations had been implemented, auditors reviewed the 1995 Auditor General's performance audit report on the collections function, obtained and reviewed information from the Department regarding the recommendations' implementation status, observed division staff to verify the controls contained within the Division's current computer system that help ensure division staff adhere to policies regarding liens, levies, and payment plans, and developed additional recommendations as appropriate. In addition, to identify best practices for collections, auditors reviewed performance audits of other states' departments of revenue and from the U.S. Government Accountability Office.[1]

1 The state audit reports reviewed were Kansas, Michigan, North Carolina, Oregon, and Utah.

- Further, in order to make general comparisons to Arizona, auditors conducted phone interviews with an IRS representative and representatives from seven states that were chosen because they were Western states that had similar tax types as Arizona or were states identified as using some type of debtor profiling.[1] Debtor profiling considers factors such as the taxpayer's previous collection history to identify which collections approach is most likely to succeed. Auditors also reviewed technical literature about the Department's new integrated tax system, BRITS, provided by the Division and Accenture, the Department's contractor for BRITS, to determine the type of automated features it is expected to provide for the Division. Additionally, auditors reviewed literature on other states' use of credit card payments. Finally, auditors reviewed audit reports or other publications on other states' and IRS' experience with electronic fund transfers.[2]

- To develop the Introduction and Background section, auditors conducted interviews with division management and staff, and Accenture staff, and compiled information from state laws, the Master List of State Government Programs, unaudited information from the Department's 2004 annual report, the Department's position tracking list, the Department's Web site, the Department's financial schedules and performance data, and division policies and procedures.

The audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the director, assistant director for collections, and staff of the Department of Revenue for their cooperation and assistance throughout the audit.

1 The states contacted were Colorado, Idaho, Iowa, Massachusetts, New Mexico, Utah, and Virginia.

2 The literature review included: (1) United States General Accounting Office. *Report to Congressional Requesters: Tax Administration: Increasing EFT Usage for Installment Agreements Could Benefit IRS: 1998.* Washington, D.C.: GAO, June 1998 (The GAO has since changed its name to the United States Government Accountability Office); (2) Swope, Christopher. Fee or Free? *Governing,* July 2001; and (3) North Carolina, Office of the State Auditor. *Performance Audit: North Carolina Department of Revenue: 2000.* Raleigh, NC: October 2000.

FINDING 1

Division could improve collections by expanding matching programs

The Division has taken several steps to improve its ability to help it find and seize the wages and bank accounts of taxpayers who have not paid their taxes, but additional steps could be taken. The Division has taken such steps as implementing automated processes to find and levy taxpayers' wages or bank accounts and participating in a yearly federal tax refund off-set. While the Division has made progress in adopting automated matching programs, some additional opportunities remain. Specifically, the Division should consider improving the matching program that is used to identify wage levy sources, consider new matching opportunities with entities such as Arizona banks, and take steps to establish a matching program with the State Lottery.

Key Matching Program Terms

- **Automated Wage Matching and Levy**—A computerized comparison, or matching, of employment records and collection accounts to identify defaulting taxpayers' employers. If an employer is identified, a computer system automatically generates a levy notice to the employer to seize monies from a taxpayer's paycheck.
- **Automated Bank Matching and Levy**—An automated comparison, or matching, between bank records and collections accounts. If a match is found, meaning the defaulting taxpayer holds a bank account, a computer system automatically generates a lien notice to the bank to seize monies from the taxpayer's account.
- **Levy Source**—The institution or individual who provides or pays monies to the Division in response to a levy because they are holding monies owned by the taxpayer. For example, in the case of a wage levy, the employer would be the levy source. Similarly, in the case of a bank levy, the bank would be the levy source.

Automated wage matching and levy programs added, but could be further improved

Automated wage matching and levy programs the Division has created since 1995 could be further enhanced. The Department began working with the Department of Economic Security (DES) in 1995 to match delinquent individual income tax collections accounts with the DES unemployment insurance tax database in order to identify wage levy sources. While this program addresses several prior performance audit recommendations, the Division can increase the program's effectiveness by expanding the number of accounts included in the process, pursuing statutory authority to match information against an additional database, and reducing the time that passes before an account is assigned to a collector for further action.

Programs address previous concerns—By adopting an automated matching and wage levy program, the Division has addressed several recommendations from a 1995 Auditor General's performance audit report of the collections function. The 1995 report found that the collections function would benefit from automating the wage levy process because collectors who had to establish wage levies manually were not doing so in a timely manner. In addition, the audit found that over 1,300 state employees owed approximately $1.9 million in taxes, and the Department had no specific methods of finding and issuing wage levies for state employees.

The Department implemented automated wage matching and levy processes.

The Department has since implemented a matching program and automated levy process to help address the auditors' concerns. More specifically:

- **Automated wage matching**—During the 1995 audit, the Department began working with the Department of Economic Security (DES) to identify wage levy sources by matching delinquent individual income tax accounts with the DES unemployment insurance tax database. According to division staff, the matching program became fully operational in 1997. The DES database contains quarterly wage information from Arizona employers on the majority of people employed in the State of Arizona. Division staff report that DES is provided with a computerized list of the primary and secondary social security numbers associated with delinquent accounts each week. DES then compares the Division's list with the employment database and provides any resulting matches to the Department. These matches are subsequently uploaded to the Division's computer system and made available to division collectors, who can then identify potential wage levy sources.

- **Automated levy**—Beginning in October 2003, the Collections Division established an automated levy for the DES wage match. According to division staff, this process places new delinquent individual income tax accounts owing between $50 and $3,000 in an automated matching and levy process for a 60-day period. During this 60-day period, a collector is not actively working the account; rather, several matching attempts are made with the DES database, and when a match is made, the Division's computer system automatically generates a wage levy.

Division programs could improve in several ways—While the DES matching and automated wage levy programs address several concerns and recommendations made in the 1995 Auditor General's performance audit, auditors noted that several improvements could be made to enhance their effectiveness. Specifically, the Department should consider:

- **Including and expanding the number of eligible accounts in the automated wage matching process**—Auditors determined that a sizable number of delinquent accounts are excluded from the DES wage levy matching programs but could be included. For example, in one June 2005 weekly match attempt, the Division reported that out of approximately 84,000 accounts, over 12,000 had to be excluded because they were connected to federal audit information. According to the IRS disclosure officer for Arizona, by federal law, the Department is required to keep confidential all taxpayer information it receives from the IRS that is considered to be solely sourced from federal tax information, meaning the taxpayer information was not previously known in the Arizona tax system. However, auditors determined through information provided by the disclosure officer that some cases the Division currently excludes from the DES wage match could be included and that steps could be taken to include the remaining cases.

  The Division currently excludes all accounts that are coded in the Department's computer system as being nonfilers brought to the Department's attention via information received from the IRS. According to division staff, this nonfiler code includes both (1) taxpayers who have an established Arizona account and failed to file in a particular year and (2) new accounts or new taxpayers who have never filed Arizona taxes. According to the IRS disclosure officer, only in the case of a new nonfiler account would the social security number be considered federal tax information. Further, according to the IRS disclosure officer, the Division could include new nonfiler accounts in the match if it verified the account information with a non-IRS secondary source and rekeyed the account information into the computer system. For example, the Division could annually request a download of the DES unemployment insurance tax wage database and rekey any new nonfilers who are identified.

  The Division should take action to include both of these groups. It should take steps to determine which nonfilers' cases had an established Arizona account and include those in the DES wage match. For the new nonfiler cases, the Division should explore the feasibility of verifying the account information with a non-IRS secondary source. If the Division is unable to effectively separate new nonfilers from those with an existing Arizona account, the Division should take steps to verify both types of accounts with a non-IRS source.

The Division could include cases excluded from the wage match.

- **Requesting a legislative change to match with an additional database**—To further enhance the speed with which a delinquent taxpayer's wages could be identified, the Department should consider requesting a legislative change to use an additional DES database for matching purposes. A.R.S. §23-722.01 currently requires that all employers doing business in Arizona report the hiring, rehiring, or returning to work of any employee who resides or works in this State to DES within 20 days of hire. Statute currently restricts the use of this database to DES for the administration and enforcement of child support, the identification and prevention of benefit fraud, and the administration of employment security services. Although this database was originally developed to aid in the enforcement of child support, and to identify and prevent benefit fraud in assistance programs, it is a state directory that could be used for other purposes if statute was broadened. Requesting a legislative change to A.R.S. §23-722.01 to enable the use of this database for collections matching may improve the chance of locating an individual while he or she is employed and taking immediate action to collect past-due taxes owed to the State.

Assigning cases more quickly to collectors—According to division staff, an account is currently kept in the automated wage levy matching program, without the benefit of an active collector, for a 60-day period. This 60-day period allows multiple weekly match attempts with the DES wage information. However, the DES wage information is updated only quarterly, with the exception of a late filing. As a result, the matching information may not change during the 60-day period. The Division should consider decreasing the amount of time a new account spends in this automated process and moving the account more quickly to the next level of enforcement. Making such a change may need to be revisited, however, if the Department receives authority from the Legislature to use DES' new-hire database. The information from this database may change more often.

Automated bank matching and levy programs initiated could be more effective

The Division should consider expanding the matching programs that identify delinquent taxpayers' bank accounts. To find bank accounts to levy against, the Division has adopted an automated program that works with IRS data—and soon with department data as well. However, the Division should continue to explore other bank account matching possibilities and automatically notifying collectors if matches are identified.

Several programs implemented or in development—As it did with wages, the Division has taken several steps to strengthen the matching of delinquent tax records with bank account information. More specifically:

- Automated bank matching—According to division staff, in June 1994, the Department began submitting a listing of delinquent individual income tax accounts to the IRS for matching against the taxpayers' 1099 tax information, which shows interest income accounts, such as savings accounts. According to division staff, the Division sends a listing of delinquent individual income tax accounts to the IRS monthly for matching, and the match results are returned to the Division within a 1-month period. As with the DES wage matching results, the IRS match results are located on the Division's computer system, which is accessible to division collectors.

- **Automated levy**—In March 2003, the Division added an automated levy component to this match. According to division staff, individual income tax accounts with tax debts between $50 and $3,000 are automatically compared with the results of the IRS match for a 60-day period. During this automated bank levy process, which occurs immediately after the 60-day automated wage levy process discussed earlier, the account is not actively worked by a collector; rather, when a match is made (meaning a bank account is located), the Division's computer system generates a notice to the bank to levy monies in the taxpayer's account. However, according to division staff, the automated bank levy program currently produces few results. Therefore, the Division should assess whether it would be beneficial to move the case to a collector sooner.

Enhancements available through BRITS—Division staff also report that in late 2005, the new computer system is expected to add the ability to capture taxpayer bank account information known to the Department. This new computer system is being implemented as a part of the Business Reengineering/Integrated Tax System (BRITS) project.[1] The new computer system will add several new capabilities. For example, when a taxpayer submits an electronic or paper return and writes a check to the Department of Revenue, the account information will be captured in the computer system and accessible to the collector to easily identify the levy source. The Division reports that, in the future, this internal banking information may be used to automatically match accounts and issue levies. Currently, collectors can find such information only through a manual check of department records.

Internal banking information that should become available through BRITS may be used to issue levies.

Division should explore other bank matches—The Division should explore other opportunities to find delinquent taxpayer bank accounts. The Division has a process in place under which banks in Arizona are asked on a case-by-case basis whether a particular taxpayer is an account holder. Although the Division has the authority to make this request on a case-by-case basis, as noted in the 1995 report, these "mass levies" add processing costs to the financial institution and to the Department. Specifically, the financial institution must research and respond to the Division's levy requests, even when the debtor has no account with the bank. Additionally, the Division must produce, sort, and mail levy documents for each bank request. According to division staff, between six to eight financial institutions are sent levy request documents for each account, and, during the last quarter of fiscal year 2005, mass levies were issued for over 1,200 accounts.

1 In August 2002, the State entered into a contract with Accenture, a global management consulting firm, to reengineer its core business processes and organizational structure, and implement an integrated tax system. With BRITS, all taxpayer data will be entered in and available through this one integrated system.

Other less-burdensome alternatives may be available for identifying delinquent taxpayers' bank accounts. For example, Massachusetts General Laws authorize the Commissioner of Revenue to implement and operate a financial institution match system to be used for the administration of tax laws. This allows for the Massachusetts Department of Revenue to require financial institutions to either provide a listing of their current account holders on a quarterly basis to the Department of Revenue for the purpose of matching collection accounts or alternatively receive a listing from the Department of their collections accounts in order to conduct the match themselves. Arizona banks also have a similar reporting requirement, as state law mandates the exchange of information between financial institutions that conduct business in the State and DES in order to assist DES in the enforcement of child support orders.[1] Arizona statute defines "financial institutions" as including state and federally chartered banks, credit unions, savings and loan associations, insurance companies, and money market mutual funds. According to a DES official, this financial institutions match was established in 1998 and involves the quarterly matching of account records from 70 banks. The official reported that during May and June 2005, $1 million was collected due to this match.

The Division should seek legislative authority to establish a matching program with financial institutions.

To improve the bank levy process, the Division should request statutory authority to establish a financial institutions data match program similar to the DES program. In addition to eliminating the research associated with responding to mass levies, the institution would merely be expanding an existing automated program. According to an official from the Arizona Bankers Association, the only concern with instituting a financial data match with the Division would be whether the banks would incur significant additional costs. Therefore, the Division should work with the Arizona Bankers Association while drafting proposed legislation to minimize any unnecessary added costs for banks. For example, it might be feasible for DES to share the existing information with the Division, rather than requiring banks to submit a second set of data to the Division.

Collectors should be automatically notified when matches identified—The Division should implement a system in which collectors are electronically notified if either a wage levy match or bank levy match has been established. According to division staff, all delinquent individual income tax accounts are run weekly against the DES unemployment wage database and monthly against the IRS 1099 database throughout their collections' life cycle. However, levy notices are automatically generated only during the automated levy periods of 60 days for wages, followed by 60 days for bank accounts. According to division staff, although a match may occur after this period, the collector needs to manually look up this information. According to a division official, collectors may be responsible for handling hundreds of cases, making automated notification helpful in ensuring they are notified immediately that a potential levy source has been identified so action can be taken.

1 A.R.S. §25-523.

According to division staff, since individual income tax accounts will not be transitioned to the Department's new computer system until the next couple of years, it may not be cost-effective to create a fully automated notification process in the current system. However, an interim report that identifies new matches could be developed and distributed to collectors with little difficulty. Therefore, the Division should consider implementing an interim notification system for wage and bank levy matches, and consider building in an automatic notification function once individual income tax accounts have been converted to the new computer system.

Other potentially useful matching programs under development

The Division is also in the process of implementing new matching programs. Specifically, the Division is working with the federal government to identify delinquent taxpayers' federal tax returns for potential levy. Additionally, the Division is currently restarting a past program to identify and levy the monies of state vendors owing tax debts and is taking steps to develop a matching program with the State Lottery to levy a delinquent taxpayer's lottery winnings.

Division participating in federal refund offset program—In fiscal year 2003, the Division instituted a matching program with the U.S. Department of the Treasury, Financial Management Services to offset/intercept federal tax refunds to satisfy a taxpayer's individual income tax debt. This match is conducted once a year and, per a federal requirement, includes notifying the taxpayer via certified mail of the intention to offset the return unless payment arrangements are made within 60 days of the notice date. The Division selects cases for this match based on criteria such as age of the account and the amount owed and must also request special funding from the Department to cover the postage costs of the certified letter. According to the Division, in fiscal year 2005, the Division spent over $89,000 to pay for postage, which allowed for 16,924 individual income tax accounts to be submitted for the match. Based on division information, of the accounts submitted, over 30 percent were offset/matched and resulted in collecting close to $1.3 million. Since inception, the Division has collected more than $5 million in delinquent taxes through this program.

The federal offset program has resulted in more than $5 million in collections.

According to the Division, in March 2004, the Department of the Treasury approved allowing an offset of federal tax refunds for withholding tax accounts. The Department estimates that the computer programming necessary for a withholding offset program may be completed by December 2005, which would allow for cases being included for matching/offset to capture 2005 refunds.

Division working to reestablish matching program for vendors—The Division is reinstituting a program to identify state vendors who owe taxes so that it

can levy state payments to these vendors. This program will help address a concern in the 1995 Auditor General performance audit. Specifically, the 1995 audit report noted that almost 600 vendors doing business with the State owed a total of approximately $1.9 million in past-due taxes. The Division reported that from 1996 to 2000, the Division had a matching program for state vendors, but the program was discontinued in 2000 because the results did not justify the expense. This program involved the Division's matching its information against a tape provided by the Arizona Department of Administration of all registered vendors, regardless of whether they had an active contract with the State. According to division staff, including all registered vendors may have contributed to the program's discontinuation, as division resources were used to research vendors who were registered but did not have active contracts.

Only vendors with active state contracts will be included in the vendor matching program.

Division staff said they recently began writing the computer programming necessary to restart the vendor matching program. However, in an effort to make it efficient, this match will be modified to include only those vendors with active contracts. Matching only active vendors will eliminate unnecessary research and focus only on vendors who are receiving state monies to offset their tax debts. Other government agencies use similar programs to pursue vendors. For example, according to an IRS official, the IRS has a process by which federal vendors' payments can be used to offset their tax debts. Similarly, a Massachusetts Department of Revenue official reports operating a vendor matching program. Because the Division's vendor matching program was determined to be unprofitable in the past, the Division should continue to monitor its results for a 1-year period to determine whether it should be continued.

Division taking steps to develop a matching program with the Lottery—The Division is taking steps to implement a 1986 statute allowing for Arizona agencies, including the Department of Revenue, to participate in a debt offset program with the State Lottery. Established in 1986, A.R.S. §5-525 allows agencies to which a debt is owed to provide a listing of the debtors to the Lottery Commission to capture any lottery winnings of $600 or more. According to a State Lottery official, agencies and entities currently participating in the Lottery's offset program include the Department of Economic Security, Division of Child Support Enforcement, the Food Stamp program, the Supreme Court, and Northern Arizona University. According to a department official, earlier efforts to establish a matching program with the Lottery were unsuccessful because of technological and resource limitations. However, the official also indicated that several years have passed since the last attempt, and the Department is currently in discussions with the Lottery to explore participating in the Lottery's offset program or establishing some type of alternative match that will enable the Division to levy a delinquent taxpayer's lottery winnings.

Recommendations:

1. The Division should consider improving and/or enhancing the DES automated wage match and levy program by taking the following steps:

    a. Determining which delinquent accounts currently excluded from the DES wage match had an established Arizona account and including those accounts in the match.

    b. Exploring the feasibility of verifying nonfiler taxpayer account information deemed to be confidential based on federal law with a non-IRS secondary source and rekeying that information so that these accounts can also be included in the wage match and levy programs.

    c. Requesting the Legislature to amend A.R.S. §23-722.01 to allow the Department to match delinquent taxpayer accounts against the new-hire information that is required to be provided to DES under its child support enforcement program.

    d. Decreasing the amount of time a collections account stays in the DES automated wage matching and levy process. Making such a change may need to be revisited, however, if the Department receives authority from the Legislature to use DES' new-hire database.

2. The Division should assess whether it would be beneficial to move a case in the automated bank levy match to a collector sooner than 60 days.

3. The Division should work with the Arizona Bankers Association to draft potential statutory changes and then request the statutory authority to establish a financial institutions data match to receive complete account holder information from Arizona financial institutions for the purpose of identifying levy sources for delinquent taxpayers.

4. The Division should consider implementing an interim notification system for wage and bank levy matches and consider building in an automatic notification function once individual income tax accounts have been converted to the BRITS system.

5. After the state vendor program has been implemented, the Division should continue to monitor its results for a 1-year period to determine whether it should be continued.

6. The Division should take the steps necessary to establish a matching program with the State Lottery to levy a delinquent taxpayer's winnings.

FINDING 2

Division could improve automated collection tools

The Division can further improve some of the automated tools it has added to enhance collections. The Division is in the process of implementing debtor profiling, which is a way to more appropriately target the extent of collection activity. The Division should periodically evaluate this program to ensure it is effective. The Division should also consider whether automation can be used in other ways, such as ensuring that cases approaching the statute of limitations are identified and reviewed prior to expiration. Finally, as more activities are converted to the new computer system, BRITS, the Division needs to ensure that automated controls are in place for key collection activities.

Debtor profiling should help focus collection efforts

The Division is modernizing its collection practices by including debtor profiling. Debtor profiling considers factors such as the taxpayer's previous collections history to identify which collections approach is most likely to succeed. The Division is already using some form of debtor profiling on individual income, transaction privilege, and withholding tax accounts. Once the Division fully implements its debtor profiling program, it should periodically evaluate how well the program is working and may need to redistribute its staffing resources.

Debtor profiling directs stronger collection actions against those taxpayers avoiding payment.

Profiling considers several factors to determine collections approach—Debtor profiling promotes a more fair and equitable treatment of taxpayers by directing stronger collection actions against those taxpayers avoiding payment rather than those willing to comply. In general, debtor profiling models take into consideration information about debtors, such as whether they have had collection cases in the past and whether they pay their debts in a timely manner. Such information is then used to predict the likelihood that a taxpayer will pay. For example, a taxpayer who is predicted to be likely to pay may initially receive only an automated letter requesting payment, especially if a small amount is owed. In contrast, a taxpayer who is predicted to be less likely to pay and more likely to require intensive collection efforts may be immediately referred to a collector for direct contact.

Division adopting debtor profiling—The Division's use of debtor profiling helps address a recommendation made in the 1995 Auditor General performance audit report (see Auditor General Report No. 95-17). The 1995 report found that the Department generally used the same approach for all collection cases without considering how likely it was that a taxpayer would pay. In November 2002, as a part of the Department's BRITS project, the Division began working with a private credit scoring firm to develop risk profiles. To develop the risk profiles, several factors are considered, such as the taxpayer's history of payment with the Department, current balance, and commercial credit score. For example, for individual income tax accounts, each account receives a score of very low, low, medium, or high, which indicates the risk associated with the account and directs the type of collections activities the collector should perform.

The Division is implementing debtor profiling for all tax types.

These risk profiles became fully operational for individual income tax collection accounts in November 2003. In October 2004, the Department also implemented debtor profiling for transaction privilege tax and withholding tax accounts. While the taxpayer's commercial credit score is not considered, factors such as the amount and number of the delinquencies are used to assess account risk and direct the type of collection action. As the implementation of the BRITS project moves forward, the Division will develop debtor profiling for corporate income tax accounts. According to division staff auditors spoke with, corporate tax accounts are expected to be converted to BRITS in July 2006.

Program should be monitored and revised as needed—To ensure that its debtor profiling program is effective, the Division should periodically evaluate how well it is working and revise it as necessary. Through this evaluation process the Division may determine that other factors should be considered. For example, the current profiling system does not consider the age of the account, but accounts generally are harder to collect as they age.

Field and office collections staffing needs should be evaluated as debtor profiling is implemented.

As the Division's debtor profiling models are implemented and evaluated, the Division should also review the distribution of its caseload and staffing resources. Since debtor profiling assesses a risk level that directs the level of enforcement and treatment of the collections case, it is possible that the profiling may result in identifying a significantly higher or lower number of cases that need more direct, aggressive collection techniques. Therefore, based on the results of the model outcomes, the Division should evaluate the needs for staffing adjustments in office and field collections, which use different levels of enforcement action to bring about case closure.

Additional processes should result in improved collections

The Division should continue its efforts to implement processes that will enhance its ability to increase the amount collected as well as the number of taxpayers paying. In January 2003, the Department expanded its efforts to initiate collection activities more quickly. However, the Division should also consider using automation to identify and assign all cases to be reviewed for any additional collections activities that could be taken before the statute of limitations deadline.

Collection action is being taken sooner—In January 2003, the Department expanded its efforts to more quickly initiate collection activities on new individual income tax accounts. Historically, taxpayers who owed under $200 received seven bills and their account was not transferred to the Collections Division for approximately 1 year, while larger accounts moved into Collections much more quickly. Through the BRITS project, the Department initiated a process whereby new accounts valued under $200 receive only one bill and one final notice, as larger accounts do, before being moved to the Collections Division.

By reducing the time between automated billing and collection activity, the Department is expecting to increase its collection revenue and lower its costs. Because the likelihood for an account to be collected decreases as it ages, the reduced timeline may enhance the likelihood that the account is paid. Additionally, the Department expects to reduce its postage costs as fewer bills are mailed.

Reviewing cases before they expire—The Division should also ensure that it has taken appropriate steps to collect on all accounts before they reach their statute of limitations. Per statute, the Department has 6 years from when a tax debt is identified to collect the debt. However, the Collections Division has not established a consistent time frame for reviewing cases before they expire and has not ensured that all tax types are encompassed in the review. For example, the Office Collections section reports identifying and attempting collection on individual income and corporate income tax accounts 90 days before expiration. By contrast, the Field Collections section reports identifying and reviewing individual income and corporate income tax accounts 1 year prior to expiration. As the length of time allotted to reviewing and focusing on these cases varies considerably by division section, the Division should evaluate the most appropriate time to begin this review. Specifically, the Division should consider whether accounts in Office Collections should be automatically identified for review sooner than 90 days before expiration to ensure an appropriate amount of time for enforcement action and a sufficient number of staff assigned to complete the review.

Additionally, the Division should expand the review of accounts nearing their statute of limitation to all tax types. According to division management, because of issues

Transaction privilege and withholding tax accounts nearing their statute of limitations' expiring are not reviewed.

with BRITS implementation, the Division had been unable to identify transaction privilege and withholding tax accounts nearing their statute of limitations' expiring. However, according to department staff working on BRITS implementation, these reports have been available since the end of 2004, but lack of interagency communication led to the reports not being requested or generated. Therefore, the Division should ensure that transaction privilege and withholding tax cases nearing their statute of limitations' expiring are also identified and reviewed for any additional collection activities.

BRITS needs key automated controls

As the Department converts more of its activities to BRITS, the Collections Division needs to ensure that automated controls are in place for key collection activities. The 1995 Auditor General performance audit report found that collections staff were not consistently following policies for levies, liens, and payment plans. For example, the 1995 report found that staff waited an excessive amount of time to file levies or filed levies before all requirements were met, such as a review of DES employment records or a credit bureau check. Similarly, the 1995 report noted that liens were also issued later than required by policy, and collectors were allowing taxpayers who had broken payment agreements to enter into new agreements, which in some cases were for an unreasonably long time. However, the report noted that when staff followed policy, more tax revenue was collected.

The Division's old computer system, which is currently used to process individual and corporate income tax accounts only, has since been augmented with many automated controls, which increase the likelihood that collectors follow division policy regarding liens, levies, and payment plans. For example, automated controls are in place in the old system to limit payment plan lengths and amounts that collectors can establish without supervisory review. Likewise, the old system automatically routes liens and levies requiring review to supervisors. However, the lien and levy function for transaction privilege and withholding tax accounts in BRITS is not yet functional. According to division staff, it is the Department's intention to build these same types of features into the BRITS system. Given the importance of these controls, the Division should ensure that BRITS includes automated controls for key collection activities, such as levies, liens, and payment plans.

Recommendations:

1. The Division should regularly review and evaluate the results of its debtor profiling program and revise it as necessary.

2. The Division should assess whether it needs to redistribute its workload or staffing based on how cases are scored through the debtor profiling program.

3. The Division should consider whether accounts in Office Collections should be automatically identified for review at an interval sooner than 90 days before expiration to ensure an appropriate amount of time for enforcement action and a sufficient number of staff assigned to complete the review.

4. The Division should expand the review of accounts nearing their statute of limitation deadline to include all tax types.

5. The Division should ensure that BRITS includes automated controls for key collection activities such as levies, liens, and payment plans.

FINDING 3

Division should take steps to provide taxpayers additional options to pay debts

The Division can further encourage taxpayers to pay their tax debts by making it easier to do so. First, the Department should continue working toward accepting credit card payments from taxpayers, including those with past-due taxes. Similarly, in-line with the IRS' and other states' practices, the Division should enable taxpayers who owe past-due taxes to pay through automatic withdrawals. Finally, allowing low-risk taxpayers to set up payment plans through automatic telephone or Web-based systems may also encourage more taxpayers to pay their debts.

Accepting credit cards would provide another option for paying past-due taxes

The Department is developing the capability to accept credit cards for tax payments. The 1995 Auditor General performance audit recommended that the Legislature consider giving the Department statutory authority regarding convenience fees, which was necessary for it to accept credit card payments in order to encourage more taxpayers owing past-due taxes to fulfill their obligation. Legislative changes were made in 2000 and 2001 to authorize state agencies to accept credit cards. However, the Division's authority was limited to accepting credit cards through Web-based transactions. When the changes were made, the Legislature specifically prohibited the Department from absorbing any fees charged by the credit card companies associated with credit card transactions so that the Department would receive the full tax amount owed.[1] The Department has identified three financial institutions that are willing to process credit card transactions and charge the convenience fees to the credit card holder.[2]

The Department received statutory authority in 2000 and 2001, which led to its ability to accept credit cards through Web-based transactions.

1 Laws 2000, Chapter 311 and Laws 2001, Chapter 354. The prohibition against absorbing fees does not extend to other state agencies.

2 The Department reports that it expects that taxpayers would be able to choose from a list of financial institutions willing to process the credit card transactions for the Department. This list will include the financial institutions' respective convenience fee rates, which are expected to range between approximately 2.5 to 5 percent.

However, there are two major hurdles to expanding this program to taxpayers with past-due taxes. First, the Department is statutorily authorized to accept credit cards only through the Web. However, not all taxpayers may choose to fulfill their tax obligation through a Web-based transaction. The Department does not accept credit card payments at walk-in centers or on mail-in forms. Therefore, the Division should consider requesting a statutory change to broaden its authority to accept credit card payments for non-Web-based transactions.

Credit cards are widely accepted by other states and the IRS for payment of past-due taxes.

Second, the Department's computer system does not yet accept credit cards. As part of the BRITS project, the Department reports that it is developing the ability to accept credit card payments for nondelinquent tax payments. The Division should work to ensure credit card payments can also be accepted for collections accounts. Auditors identified other revenue collection agencies that use this practice. For example, the IRS accepts credit card payments for tax payment transactions, including collection accounts, and its credit card payments are processed through an intermediary company so that the taxpayer rather than the IRS pays the fee.

Automatic withdrawals could reduce default rates and costs

Some taxpayers who owe large amounts are already required to pay some taxes through electronic fund transfers.

The Division, which currently does not have the statutory authority to accept automatic withdrawals from the bank accounts of delinquent taxpayers who are on payment plans, could potentially improve tax collections and reduce costs by seeking and using this authority. The 1995 Auditor General report noted that taxpayers' compliance with payment agreements could be improved significantly by mandating the use of automatic withdrawals, also known as electronic funds transfers (EFT), for those delinquent taxpayers with bank accounts. The Department has the statutory authority to accept automatic withdrawal payments in other areas of its tax administration function. For example, the Department accepts electronic funds transfer payments from certain businesses. For example, EFT is required from taxpayers who paid $1 million or more in transaction privilege taxes during the prior year and taxpayers who had quarterly average withholding tax liability of $20,000 or more during the prior year.

The IRS and several other states have such a practice in place and use it to reduce default rates and operating costs. For example:

- According to a California Franchise Tax Board manager, when California implemented an EFT requirement for personal income tax payment plans in 1997, the default rate for these accounts was over 40 percent. Since the implementation of the EFT requirement, the default rate has not exceeded 3 percent. By comparison, Arizona's default rate for collections of individual income and corporate income tax collection accounts between March and June 2005 exceeded 26 percent, according to division staff.

Accepting automatic withdrawals for payment plans can reduce default rates and administrative costs.

- An IRS representative who auditors spoke with indicated that the use of automatic withdrawals significantly reduces the default rate. A 1998 United States Government Accountability Office (GAO) report noted that automatic withdrawals reduce the likelihood that taxpayers will default on their payment plans by removing the potential that taxpayers will forget to make their payments or submit the wrong amount.[1]

- Automatic withdrawals also reduce agency costs by eliminating the work associated with processing checks, as well as reducing postage and paper costs associated with mailing bills. For example, the 1998 GAO report noted that officials from California's Franchise Tax Board and Minnesota's Department of Revenue reported administrative cost savings through reduced paper processing and mailing costs.

According to the private contractor developing the system, BRITS has the technical capability to support automatic payment plans. However, the Division and its contractors have not yet resolved whether it would be included in the scope of the BRITS contract. A California Franchise Tax Board official who auditors spoke with indicated that the agency was able to use in-house programmers and minimal resources to implement automatic withdrawals for payment plans because, like Arizona, automatic withdrawals were already being accepted for other transactions within the agency.

Division should consider allowing taxpayers to establish payment plans by phone or Internet

The Division should consider allowing delinquent taxpayers with a positive history of paying their tax obligation to set up their own payment plans through an automated telephone or Web-based system. Auditors identified other states that report that they have reduced inbound telephone calls and encouraged taxpayer compliance through this approach. For example:

- In December 2001, the Virginia Department of Taxation implemented a system that allows delinquent taxpayers to set up their own payment plans using an automated telephone system. According to a Virginia Department of Taxation official, this system was purchased for an initial cost of $104,000 with annual

1 U.S. General Accounting Office. *Tax Administration: Increasing EFT Usage for Installment Agreements Could Benefit IRS*. Washington, D.C.: GAO, June 1998.(The GAO has since changed its name to the U.S. Government Accountability Office.)

maintenance costs of under $4,000. According to a private contractor who worked with the system, this approach was adopted, at least in part, because a significant amount of telephone calls in the collections unit involved setting up payment plans. For example, a Virginia official reported that the automated payment plan system's normal call load is about 300 calls per day, resulting in about 70 payment plans. Additionally, they report that since inception, Virginia's automated system has been used 47,290 times to set payment arrangements totaling over $50 million.

- Information that auditors received from the Massachusetts Department of Revenue indicates that Massachusetts allows taxpayers who owe less than $5,000 to set up payment plans by telephone or on the Department's Web site. Taxpayers setting up their payment plan through the Web site can pay through several means, such as automatic withdrawal or credit cards.

The Division should assess the feasibility of establishing a similar program. The Division could use its debtor profiling program to determine which taxpayers could be allowed to participate. In addition, the Division will need to determine whether it would be feasible to use an automated phone system, a Web-based system, or both. By allowing low-risk taxpayers to set up their own payment plans, the number of incoming calls would be expected to decrease. This would allow the Collections Division to focus on the remaining callers and/or refocus resources on other needed tasks while encouraging taxpayers to make payment arrangements according to their own preferences and needs.

Recommendations:

1. The Division should seek statutory authority to accept credit card payments for non-Web-based transactions.

2. The Division should ensure, as a part of the BRITS project, that it can accept credit cards for collection accounts.

3. The Department should consider seeking statutory authority to accept automatic withdrawal for payment plans.

4. The Division should assess the feasibility of developing a telephone and/or Web-based system through which low-risk taxpayers can set up their own payment plans.

AGENCY RESPONSE

STATE OF ARIZONA

Department of Revenue
Office of the Director
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Janet Napolitano
Governor

Gale Garriott
Director

September 28, 2005

Ms. Debbie Davenport
Auditor General
Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Davenport:

The Department of Revenue (Department) has reviewed the performance audit and sunset review of the Collections Division. The following comments are provided as the Department's response to the findings and recommendations.

Finding 1 – Division could improve collections by expanding matching programs.

Recommendation 1 - The Division should consider improving and/or enhancing the DES automated wage match and levy program by taking the following steps:

a) Determining which delinquent accounts currently excluded from the DES wage match had an established Arizona account and including those accounts in the match.

b) Exploring the feasibility of verifying non-filer taxpayer account information deemed to be confidential based on federal law with a non-IRS secondary source and re-keying that information so that these accounts can also be included in the wage match and levy programs.

c) Requesting the Legislature to amend A.R.S. §23-722.01 to allow the Department to match delinquent taxpayer accounts against the new-hire information that is required to be provided to DES under its child support enforcement program.

d) Decreasing the amount of time a collections account stays in the DES automated wage matching and levy process. Making such a change may need to be revisited, however, if the Department receives authority from the Legislature to use DES' new-hire database.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

The Department is always looking for new and innovative ways to improve collections revenues. There is some concern regarding compliance with IRS disclosure rules, thus a meeting to discuss the potential process to share data will be scheduled. However, because the Department would only be sharing primary and secondary social security numbers, it is anticipated any issues of disclosure would be negated.

The Division has already set in motion steps to explore the implementation of this recommendation. A meeting is being scheduled with the IRS and DES to review the issues surrounding data sharing practices. Upon completion of that meeting it is anticipated the process of analyzing data requirements and mapping the process for data exchange could begin. Finally a review of the existing IGA between the Department and DES would take place, and modifications made as required.

The Department is currently reviewing A.R.S. §23-722.01 and will be meeting with DES to determine if legislation is required to allow the exchange of new hire information. Discussions with DES will also include any state and federal hire reports data that may be currently available for sharing. Should legislation be required to share new hire information the Division will work with stakeholders to obtain the necessary statutory permission.

It is agreed that the time an account resides in the levy process is excessive. The Division will take immediate steps to reduce the time in this category from 60 to 30 days. (See response to Recommendation 2 below)

Recommendation 2 - The Division should assess whether it would be beneficial to move a case in the automated bank levy match to a collector sooner than 60 days.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

In response to the recommendation, a review has been conducted of both the wage matching and levy procedures and the automated bank levy process. As a result, it has been determined that the bank levy step in the process should be eliminated. In its place the changes developed to address Finding 1, Recommendation 3 of this report will be implemented.

Implementation of the recommendation will require specific processes. First, the time allotted to identify wage levy sources through the automated wage matching process will be reduced from 60 to 30 days. If no levy source is identified within that 30 day period, the account will move to a newly created bank match category. During the next 30 days, an attempt to match bank customer records to collections liabilities will take place. If a match occurs, the bank account will be levied. If no levy source is found through the bank matching process the case will move immediately to an auto dial stage, and will remain there for 90 days.

Upon finalization of the new process the Division training manual will be modified and training provided to all employees. In addition, control points will be established to determine the effectiveness of the new process by measuring revenues captured at each step. Finally, an assessment of the results will be completed and modifications to the process made to ensure it is both cost effective and efficient.

Recommendation 3 - The Division should work with the Arizona Bankers Association to draft potential statutory changes and then request the statutory authority to establish a financial institutions data match to receive complete account holder information from Arizona financial institutions for the purpose of identifying levy sources for delinquent taxpayers.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

The current process of conducting research to identify bank levy source information is time consuming and costly for both the Department and banks, as is the execution of the mass bank levy process. The Division will contact the various stakeholders to explore the requirements and feasibility of moving forward with this recommendation. Activity will include seeking out necessary support to gain appropriate legislation that would provide authority for data matches with banks. Having completed the preliminary research and development actions, the required legislation will be pursued.

Recommendation 4 - The Division should consider implementing an interim notification system for wage and bank levy matches and consider building in an automatic notification function once individual income tax accounts have been converted to the BRITS system.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

The Division, in concert with IT Support staff, will work to develop the interim reporting as recommended. DES will be contacted and copies of the appropriate data files requested to match against the existing collections inventory data. The reports should identify account matches which will then automatically notify the assigned collector. As this procedure is implemented, the training manuals will be updated and collections personnel trained on the revisions.

Recommendation 5 - After the state vendor program has been implemented, the Division should continue to monitor its results within a one year period to determine whether it should be continued.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

The Division recently completed comparisons of collections accounts to the procurement database containing all active vendors approved to conduct business with the State of Arizona and is assessing the results. Any positive matches will result in enforcement action being taken. The Division foresees running the data comparisons on a quarterly basis for a one year period. Data regarding the number of delinquent vendors, the revenue collected, and the time required to complete the tasks associated with the recommendation will be maintained and analyzed to determine whether the program is cost effective and should be continued.

Recommendation 6 - The Division should take the steps necessary to establish a matching program with the State Lottery to levy a delinquent taxpayer's winnings.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

The Division agrees with the recommendation and has already initiated discussions with Lottery to determine methodologies needed to accomplish collection of taxpayer liabilities. Current discussions involve evaluating data confidentiality, operational concerns and statutory authority. Subsequent meetings will be held to explore other process alternatives to provide the most effective method for implementing this recommendation. Should a satisfactory method not be identified, the Department will seek legislation upon determining the requirements of agencies, the IRS and other parties.

Finding Two – Division could improve automated collection tools.

Recommendation 1 - The Division should regularly review and evaluate the results of its debtor profiling program and revise it as necessary.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

Currently the profiling system (Faire-Isaac) is not fully implemented. During this development time, the Division has been establishing the business rules for handling an account after profiling is complete. Action on the account will be based on several factors including the profiling score, amount of the liability and the tax type. A periodic review will be undertaken to analyze the collections information regarding payment patterns, the effective number of accounts that have been successfully contacted and revenues collected upon based on the account actions, as well as the turnaround time for the various account cycles. Additionally, modifications will be made to enhance the success of debtor profiling. Part of the analysis process will be benchmarking with other states that are using the debtor profiling process, to determine the most effective criteria to be used. Ultimately, the application will be most valuable when the BRITS program has completed conversion of individual income taxes, currently scheduled for implementation in the summer of 2007.

Recommendation 2 - The Division should assess whether it needs to redistribute its workload or staffing based on how cases are scored through the debtor profiling program.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

The Division has established the current process of caseload assignment based on the recommendations of the BRITS consultant, Accenture. The program is currently not fully implemented. While the program is being implemented, the Division will benchmark other states and public sector entities to gather information regarding program effectiveness, and how caseloads are assigned. In addition, an interim software application using profiling algorithms for businesses will be developed. To assess the results of this process, various metrics including payment patterns, collection success ratios, and account enforcement cycle times will be reviewed. When the program is fully implemented, the performance will be analyzed and any changes made as necessary.

Recommendation 3 - The Division should consider whether accounts in Office Collections should be automatically identified for review at an interval sooner than 90 days before expiration to ensure an appropriate amount of time for enforcement action and a sufficient number of staff assigned to complete the review.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

Although the Division agrees with the recommendation there is some concern about the short term impact this change will have on account inventory. Due to high turnover in the collector position and thus a staffing shortage, collectors are applied first to those accounts deemed most collectable. Because accounts approaching the Statute of Limitations are older and, therefore, typically less collectable, the Division has chosen to not concentrate limited resources on those accounts. In order to increase our focus on accounts approaching the Statute of Limitations, resources will have to be reallocated from the more current and more collectable accounts. To ensure collection revenues are not impacted the

Division will stage the transition of Office Collections from the currently scheduled evaluation period of 90 days to the new evaluation period of one year prior to the Statute of Limitations expiration. The first stage will be to move the review of cases to a period six months prior to the Statute of Limitations expiration. The second stage will transition the review period to one year prior to the Statute of Limitations expiration. At the conclusion of each stage metrics will be evaluated and the Division will proceed accordingly so that the state's revenues are not adversely impacted.

Currently both the Bankruptcy and Field sections review cases at the one year mark.

Recommendation 4 - The Division should expand the review of accounts nearing their statute of limitation deadline to include all tax types.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

Until recently the Division was unable to evaluate statute of limitation dates for all tax types. Given the availability of new data, the Division will begin applying the process steps outlined in the response to recommendation 3 to each tax type as the conversion of that tax is completed in BRITS. The Division will also continue with these process steps for tax types remaining in the Legacy system, prior to converting to BRITS.

Recommendation 5 - The Division should ensure that BRITS includes automated controls for key collection activities such as levies, liens, and payment plans.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

Development of controls for the new BRITS environment has begun. The controls will allow management to monitor individual and team performance. In addition, inventory management reports have been either newly designed or refined. When the program is complete, the Division will implement a series of controls which will monitor such items as number of liens and levies processed and/or closed, collector caseload, and controls that will provide information for improved customer service and to allow management to make informed decisions. These tools will be aligned with the strategic goals of the Department.

Finding Three – Division should take steps to provide taxpayers additional options to pay debts.

Recommendation 1 - The Division should seek statutory authority to accept credit card payments for non-Web-based transactions.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

Please refer to the Division's response to Recommendation 2 below.

Recommendation 2 - The Division should expand its plans to accept credit cards to include taxpayers with past due taxes.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

The Department agrees that statutory authority is required to accept credit cards on past due taxes and non-web based transactions. The Department will work to develop and forward the necessary language to the Legislature. As one of the key requirements of the BRITS program, it has always been the Department's intent to establish the ability to accept credit card payments for tax liabilities. This functionality is currently planned for full implementation with the conversion of individual income taxes to the new system. This capability will include not only web based transactions, but also payment arrangements via telephone contact or walk in.

Recommendation 3 - The Department should consider seeking legislative authority to accept automatic withdrawal for payment plans.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

The Department continues to seek ways to improve the payment process for the collection of tax liabilities. It is unclear if legislative action is required to implement this recommendation in circumstances where the taxpayer voluntarily requests automatic withdrawal as an alternative to traditional payment alternatives. This will be verified and, if true, will allow a faster implementation of the payment alternative. The Division will contact other states to gain an understanding of their process requirements. Meetings will be scheduled with various financial institutions, the Department's IT Division and the Comptroller's Office to identify process requirements for each of the stakeholders. If agreement is reached that legislative action is required, legislation will be crafted, with stakeholders' support, seeking appropriate authority to accept automatic withdrawals for payment of tax liabilities.

Recommendation 4 - The Division should assess the feasibility of developing a telephone and/or web-based system through which low-risk taxpayers can set up their own payment plans.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

Although the Department agrees with the recommendation, it is important that the BRITS program is fully implemented across all tax types prior to implementing this recommendation. It is equally important that the profiling system is fully operational and showing positive results. Another essential element is the installation of a new call center for the Department. There is a project request currently in the AZnet inventory for this installation with the target date for the spring of 2006. Finally, the Department is concerned about the initial capital requirements, as well as on-going maintenance costs for this application.

The Department will implement the recommendation once the above issues are satisfied. The Division intends to meet with AZnet and the Department's IT Division to define requirements. A review of the various collection publications, policies and procedures will be undertaken with the goal to make changes to include instructions for the new process. An outreach program will be planned to provide both internal Division and external user community instructions on the reasons for and use of the new application. During this process a careful assessment of costs versus benefits will be in place to assess the feasibility of continuing the program or determining any modifications necessary.

As a final comment, the Department would like to express appreciation for the professional conduct of your staff during the performance and sunset audits. Many hours were spent learning about the Department's operations and interacting with the staff. The recommendations provided are appreciated and will be implemented in a manner to achieve our common goal of improving services to the citizens of the State.

Sincerely,

Gale Garriott
Director

Performance Audit Division reports issued within the last 24 months

04-L1 Letter Report—Arizona Medical Board
04-L2 Letter Report—Gila County Transportation Excise Tax
04-L3 Letter Report—Department of Economic Security—Population Estimates
04-01 Arizona Tourism and Sports Authority
04-02 Department of Economic Security—Welfare Programs
04-03 Behavioral Health Services' HB2003 Funding for Adults with Serious Mental Illness
04-04 Department of Emergency and Military Affairs and State Emergency Council
04-05 Department of Environmental Quality—Water Quality Division
04-06 Department of Environmental Quality—Waste Programs Division
04-07 Department of Environmental Quality—Air Quality Division
04-08 Department of Environmental Quality—Sunset Factors
04-09 Arizona Department of Transportation, Motor Vehicle Division— State Revenue Collection Functions
04-10 Arizona Department of Transportation, Motor Vehicle Division—Information Security and E-government Services
04-11 Arizona Department of Transportation, Motor Vehicle Division—Sunset Factors
04-12 Board of Examiners of Nursing Care Institution Administrators and Assisted Living Facility Managers
05-L1 Letter Report—Department of Health Services—Ultrasound Reviews
05-01 Department of Economic Security—Division of Employment and Rehabilitation Services—Unemployment Insurance Program
05-02 Department of Administration—Financial Services Division
05-03 Government Information Technology Agency (GITA) & Information Technology Authorization Committee (ITAC)
05-04 Department of Economic Security—Information Security
05-05 Department of Economic Security—Service Integration Initiative
05-06 Department of Revenue—Audit Division
05-07 Department of Economic Security—Division of Developmental Disabilities
05-08 Department of Economic Security—Sunset Factors
05-09 Arizona State Retirement System
05-10 Foster Care Review Board
05-11 Department of Administration—Information Services Division and Telecommunications Program Office
05-12 Department of Administration—Human Resources Division
05-13 Department of Administration—Sunset Factors

Future Performance Audit Division reports

Department of Revenue—Business Reengineering/Integrated Tax System (BRITS)

Department of Revenue—Sunset Factors