PERFORMANCE AUDIT
OF THE

COLLECTION DIVISION

DEPARTMENT OF TREASURY

June 2002

27-150-01

EXECUTIVE DIGEST

COLLECTION DIVISION

INTRODUCTION

This report, issued in June 2002, contains the results of our performance audit* of the Collection Division, Department of Treasury.

AUDIT PURPOSE

This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.

BACKGROUND

The Division is responsible for collecting taxes after other divisions in the Department have determined tax delinquencies. The Division is also responsible for collecting unpaid accounts that other State agencies and universities are unable to collect.

Division operations are administered through a central office in Lansing and seven district offices located throughout the State. The Department of Attorney General provides legal assistance for the collection of certain accounts. The Division also contracts with a private collection agency to provide collection services for accounts referred by the Division.

As of January 31, 2001, Division records indicated that the delinquent amounts due for tax accounts and State agency accounts totaled approximately $2.3 billion and $386.7

* *See glossary at end of report for definition.*

million, respectively. Of these amounts, the Division classified $989.3 million of the balances due for taxes and $339.7 million of the balances due for State agency debt as being in active collection status.

For fiscal year 1999-2000, the Division collected $243.0 million for amounts due for taxes and $31.6 million for amounts due for State agency debt. The Division's expenditures for fiscal year 1999-2000 totaled $30.4 million. As of June 30, 2001, the Division had 144 employees.

AUDIT OBJECTIVES, CONCLUSIONS, AND NOTEWORTHY ACCOMPLISHMENTS

Audit Objective: To assess the Division's effectiveness and efficiency in collecting overdue taxes and State agency debt due the State.

Conclusion: We concluded that the Division was generally effective and efficient in collecting overdue taxes and State agency debt due the State. However, we noted reportable conditions* related to follow-up for installment agreements and tax liens (Findings 1 and 2).

Noteworthy Accomplishments: The Division has made considerable improvement in its operations at the Detroit district office since our prior audit fieldwork. Our prior audit contained a finding regarding the performance of the Detroit district office. This finding detailed five specific areas regarding employee performance standards that were not being met within this office. The current audit methodology included an examination of a sample of accounts assigned to the Detroit office. The examination disclosed no instances in which employee performance standards were not being met. The examination results demonstrated a significant improvement in the effectiveness of the operations of the Detroit district office.

* *See glossary at end of report for definition.*

Audit Objective: To assess the effectiveness of the Division's procedures and controls for recording, monitoring, and adjusting accounts receivable for overdue taxes and State agency debt due the State.

Conclusion: We concluded that the Division's procedures and controls for recording, monitoring, and adjusting accounts receivable for overdue taxes and State agency debt due the State were generally effective. However, we noted reportable conditions related to private collection agency accounts and uncollectible accounts (Findings 3 and 4).

AUDIT SCOPE AND METHODOLOGY

Our audit scope was to examine the program and other records of the Collection Division. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit procedures included examination of program records and activities for the period May 1, 1994 through May 31, 2001.

We conducted a preliminary review of the Division's operations to gain an understanding of its activities and to form a basis for selecting certain operations for audit.

We interviewed Division staff and evaluated the Division's practices, procedures, and controls. Also, we conducted tests of records related to tax and State agency accounts. In addition, we evaluated records and procedures related to the activities of the private collection agency.

AGENCY RESPONSES AND PRIOR AUDIT FOLLOW-UP	Our audit report contains 4 findings and 4 corresponding recommendations. The Department's preliminary response indicated that it agrees with our findings. The Division complied with the 5 prior audit recommendations.

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 24, 2002

Dr. Douglas B. Roberts
State Treasurer
Treasury Building
Lansing, Michigan

Dear Dr. Roberts:

This is our report on the performance audit of the Collection Division, Department of Treasury.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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TABLE OF CONTENTS

COLLECTION DIVISION
DEPARTMENT OF TREASURY

INTRODUCTION

	Page
Executive Digest	1
Report Letter	5
Description of Agency	8
Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up	10

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

Effectiveness and Efficiency in Collecting Taxes and State Agency Debt	12
1. Follow-Up for Installment Agreements	12
2. Tax Liens	14
Effectiveness of Procedures and Controls for Accounts Receivable	15
3. Private Collection Agency Accounts	16
4. Uncollectible Accounts	17

GLOSSARY

Glossary of Acronyms and Terms	20

Description of Agency

The Collection Division, Department of Treasury, is responsible for collecting taxes after other divisions in the Department have determined tax delinquencies. The Division is also responsible for collecting unpaid accounts that other State agencies and universities are unable to collect.

Division operations are administered through a central office in Lansing and seven district offices located throughout the State. The Department of Attorney General provides legal assistance for the collection of certain accounts.

The Division uses various techniques to collect amounts due the State. These techniques include installment agreements, income tax refund stops, vendor payment stops, tax liens, tax levies and warrants, and tax sales. The Division also has a contract with a private collection agency to provide collection services for accounts referred by the Division.

In addition to its collection efforts, the Division is responsible for issuing tax clearance certificates for business entities that are dissolving or changing ownership.

As of January 31, 2001, Division records indicated that the delinquent amounts due for tax accounts and State agency accounts totaled approximately $2.3 billion and $386.7 million, respectively. The delinquent amounts due (in millions) by collection status as of this date were as follows:

Collection Status	Tax Accounts	State Agency Accounts
Active collectible	$ 989.3	$ 339.7
New assessments	205.9	
In appeals	564.1	
In litigation	278.2	10.6
In correspondence review	37.3	
Pending write-off	183.8	36.4
Total	$ 2,258.6	$ 386.7

For fiscal year 1999-2000, the Division collected $243.0 million for amounts due for taxes and $31.6 million for amounts due for State agency debt. The Division's expenditures for fiscal year 1999-2000 totaled $30.4 million. As of June 30, 2001, the Division had 144 employees.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit of the Collection Division, Department of Treasury, had the following objectives:

1. To assess the Division's effectiveness and efficiency in collecting overdue taxes and State agency debt due the State.

2. To assess the effectiveness of the Division's procedures and controls for recording, monitoring, and adjusting accounts receivable for overdue taxes and State agency debt due the State.

Audit Scope

Our audit scope was to examine the program and other records of the Collection Division. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, performed from February through June 2001, included examination of program records and activities for the period May 1, 1994 through May 31, 2001.

We conducted a preliminary review of the Division's operations to gain an understanding of its activities and to form a basis for selecting certain operations for audit. This included interviews of various personnel and a review of reports and procedures.

To assess the Division's effectiveness and efficiency in collecting overdue taxes and State agency debt due the State, we interviewed Division staff and evaluated the Division's collection practices and procedures. Also, we conducted tests of records related to tax and State agency accounts. In addition, we evaluated records and procedures related to the activities of the private collection agency.

To assess the effectiveness of the Division's procedures and controls for recording, monitoring, and adjusting accounts receivable, we interviewed Division staff and evaluated the Division's procedures and controls. Also, we conducted tests of records related to tax and State agency accounts for compliance with the Division's policies and procedures.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 4 findings and 4 corresponding recommendations. The Department's preliminary response indicated that it agrees with our findings.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Treasury to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

The Division complied with the 5 prior audit recommendations.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS AND EFFICIENCY IN COLLECTING TAXES AND STATE AGENCY DEBT

COMMENT

Audit Objective: To assess the Collection Division's effectiveness and efficiency in collecting overdue taxes and State agency debt due the State.

Conclusion: We concluded that the Division was generally effective and efficient in collecting overdue taxes and State agency debt due the State. However, we noted reportable conditions related to follow-up for installment agreements and tax liens.

Noteworthy Accomplishments: The Division has made considerable improvement in its operations at the Detroit district office since our prior audit fieldwork. Our prior audit contained a finding regarding the performance of the Detroit district office. This finding detailed five specific areas regarding employee performance standards that were not being met within this office. The current audit methodology included an examination of a sample of accounts assigned to the Detroit office. The examination disclosed no instances in which employee performance standards were not being met. The examination results demonstrated a significant improvement in the effectiveness of the operations of the Detroit district office.

FINDING

1. Follow-Up for Installment Agreements

The Division needs to consistently follow up on debtors who do not make payments in accordance with their installment agreements.

Debtors who are willing, but are unable, to immediately pay the full amount owed are allowed to pay off their debts over a period of time. The Division establishes monthly payment amounts for these installment agreements based on an analysis of the financial condition of the debtors.

The Division's procedures require follow-up for debtors who do not make monthly payments in accordance with their installment agreements. Under the Division's procedures, its automated collection system should generate follow-up letters to debtors who do not make timely payments or do not make payments in the proper amount. If a debtor does not remit payment for the delinquent amount due, the automated system should suspend the installment agreement for further review and follow-up by the Division or the private collection agency.

As of January 31, 2001, Division records indicated that there were 7,894 tax accounts in installment agreement status with balances due totaling approximately $28.4 million.

We reviewed a sample of 99 delinquent tax accounts with balances due totaling $5,216,094 with installment agreements in active collection status. We determined that timely payments had not been made for the installment agreements for 34 accounts. Of these 34 accounts, follow-up letters were generated by the automated collection system for 31 accounts and appropriate follow-up was made. However, for 3 (8.8%) accounts with balances due totaling $417,885, the automated system had not generated follow-up letters or suspended the installment agreement for further review. For 2 of these accounts, no installment agreement payments had been received in over two years.

Follow-up should be made on a timely basis for all delinquent installment agreement payments to help ensure that debtors pay off their debt as required by their agreements.

RECOMMENDATION

We recommend that the Division consistently follow up on debtors who do not make payments in accordance with their installment agreements.

AGENCY PRELIMINARY RESPONSE

The Department of Treasury agrees with the finding. The Department informed us that 2 of the account exceptions are related to installment agreements that were entered into prior to the implementation of the Michigan Accounts Receivable Collection System (MARCS) on June 15, 1999. MARCS has strong functions and features to assist in reducing inadvertent omissions of notifications. It is projected that exceptions after implementation are fewer than found in this audit period.

FINDING

2. Tax Liens

The Division did not consistently record tax liens on the property of delinquent taxpayers as required by established procedures.

Section 205.29 of the *Michigan Compiled Laws* provides that the Department may record tax liens on the property of delinquent taxpayers. Tax liens are recorded with the county register of deeds office in the counties in which the properties are located as security for the payment of taxes, penalties, and interest due the State. A tax lien attaches to the real and personal property of a delinquent taxpayer on the date that the applicable tax return was due and continues for seven years or until the applicable debt is paid.

The Division's procedures provide that liens shall be recorded for assessments of $2,000 or more for delinquent business taxpayers and assessments of $500 or more for delinquent individual taxpayers, except under certain conditions. Accounts for which liens are not recorded include taxpayers in bankruptcy and taxpayers whose businesses have closed and they cannot be located.

We reviewed a sample of 99 delinquent tax accounts with installment payment agreements in active collection status. We determined that 5 (5.1%) of these accounts with balances due totaling $173,916 had assessments over the established limits, and tax liens had not been recorded on the property of the delinquent taxpayers. Based on the documentation in the Division's account records, liens should have been recorded for these 5 taxpayers.

We reviewed a sample of 60 delinquent tax accounts assigned to the private collection agency in active collection status. We determined that 5 (8.3%) of these accounts with balances due totaling $676,789 had assessments over the established limits and tax liens had not been recorded on the property of the delinquent taxpayers. Based on the documentation in the Division's account records, liens should have been recorded for these 5 taxpayers.

To protect the interests of the State, the Division should ensure that tax liens are recorded on the property of delinquent taxpayers as required by established procedures.

RECOMMENDATION

We recommend that the Division consistently record tax liens on the property of delinquent taxpayers as required by established procedures.

AGENCY PRELIMINARY RESPONSE

The Department agrees with the finding. The Department informed us that 2 of the sampling exceptions in this finding were related to installment agreements that were entered into by the taxpayer prior to implementation of all the functional improvements for MARCS. Currently, the installment agreement processing and monitoring will result in a lien being placed for all accounts with installment agreements. Any account for which a lien is not placed will be supported by a comment in the account record regarding the exception.

The Department also informed us that, in regard to delinquent tax accounts in a collectible status without tax liens, several routing problems within MARCS have been discovered within the last nine months. At the time of the conversion, all unusual correspondence accounts and exceptions were placed in the manager review status. MARCS contains a feature that allows accounts to route to individuals to be worked on. Some MARCS rules were moving accounts before a manual review could take place. This problem will continue to be monitored and improvements will be worked on both from a system perspective and manual review effort.

EFFECTIVENESS OF PROCEDURES AND CONTROLS FOR ACCOUNTS RECEIVABLE

COMMENT

Audit Objective: To assess the effectiveness of the Division's procedures and controls for recording, monitoring, and adjusting accounts receivable for overdue taxes and State agency debt due the State.

Conclusion: We concluded that the Division's procedures and controls for recording, monitoring, and adjusting accounts receivable for overdue taxes and State agency debt due the State were generally effective. However, we noted

reportable conditions related to private collection agency accounts and uncollectible accounts.

FINDING

3. Private Collection Agency Accounts

The Division needs to ensure that the private collection agency performs timely reviews and follow-up for its assigned accounts.

The collection agency provides an automated collection system as part of its contract with the Department. The collection agency uses the automated collection system to provide support for its collection efforts and to document its activities in accounts receivable records for each account. Accounts are assigned to specific functional status codes on the automated system as collection efforts are made for an account.

As of January 31, 2001, Division records indicated that the collection agency had 147,443 assigned tax accounts with balances due totaling approximately $779.1 million. As of this date, Division records indicated that the collection agency had 191,023 assigned State agency accounts with balances due totaling approximately $317.8 million.

Our review of a sample of 60 tax accounts assigned to the collection agency disclosed that 13 (21.7%) accounts with balances due totaling approximately $2.3 million had been assigned to manager review, account research, or correspondence review status for over 7 months. For 4 accounts assigned to manager review status, the accounts receivable records indicated that no reviews or follow-up had been performed for periods ranging from 8 to 13 months. For 9 accounts assigned to account research or correspondence review status, the accounts receivable records indicated that no reviews or follow-up had been performed for periods ranging from 8 to 20 months.

Our review of a sample of 70 State agency accounts assigned to the collection agency disclosed that 11 (15.7%) accounts with balances due totaling approximately $1.7 million had been assigned to manager review, account research, or correspondence review status for over 5 months. For 5 accounts assigned to manager review status, the accounts receivable records indicated that no reviews or follow-up had been performed for periods ranging from 6 to 19

months. For 6 accounts assigned to account research or correspondence review status, the accounts receivable records indicated that no reviews or follow-up had been performed for periods ranging from 7 to 12 months.

Collection efforts are suspended for accounts when they are assigned to manager review, account research, or correspondence review status on the automated system. To provide assurance that collection efforts proceed in a timely manner, the Division should ensure that the collection agency performs timely reviews and follow-up for its accounts.

RECOMMENDATION

We recommend that the Division ensure that the private collection agency performs timely reviews and follow-up for its assigned accounts.

AGENCY PRELIMINARY RESPONSE

The Department agrees with the finding. The Department informed us that the accounts that were not appropriately reviewed may have been subject to the routing problems noted in the response to Finding 2. A number of accounts cited in the finding that were not reviewed in a timely manner involved secondarily liable parties. The accounts are normally more complex. Several computer enhancements are in the design phase to improve efficiency in handling such accounts. The MARCS contract has a performance measure on account resolution.

FINDING

4. Uncollectible Accounts

The Division did not ensure that uncollectible accounts were written off on a timely basis.

For accounts receivable for overdue taxes, the statute of limitations provision in Section 600.5807(8) of the *Michigan Compiled Laws* allows collection activity for six years from the date that the Division begins its collection efforts for an assessment. The statute of limitations period starts over if a debtor makes a payment or signs an installment payment agreement. For most State agency accounts receivable, the statute of limitations period is also six years. There is no

statute of limitations for State agency accounts for mental health services and federal student loans.

The Division's procedures provide that an account should be written off as uncollectible if the statute of limitations period has expired or if all potential collection efforts have been made and there is no future collectibility.

As of January 31, 2001, Division records indicated that 182,459 tax accounts with balances due totaling approximately $960.8 million were in active collection status and did not have installment repayment agreements. As of this date, Division records indicated that 220,283 State agency accounts with balances due totaling approximately $299.3 million were in active collection status and did not have installment repayment agreements.

We reviewed a sample of 100 tax accounts in active collection status with no installment payment agreement. We determined that 10 (10.0%) of these accounts with balances due totaling $383,141 should be written off as uncollectible because the statute of limitations period had expired. Eight of these accounts had been referred to managers for write-off approval and had not been reviewed for periods ranging from 7 to 19 months after they had been referred.

We also reviewed a sample of 130 State agency accounts in active collection status with no installment payment agreement. We determined that 26 (20.0%) of these accounts with balances due totaling $3,322,699 should be written off as uncollectible. The statute of limitations period had expired for 22 accounts and all potential collection efforts had been made for 4 accounts. For 11 of these accounts, there had been no payments received or any collection activity in over 10 years. Also, 9 accounts had been referred to managers for write-off approval and had not been reviewed for periods ranging from 9 to 23 months after they had been referred.

An accurate record of accounts receivable in active collection status is necessary for the Division to effectively evaluate its work load and collection efforts. To help ensure that the balances for active accounts receivable are accurate, uncollectible accounts should be written off on a timely basis.

RECOMMENDATION

We recommend that the Division ensure that uncollectible accounts are written off on a timely basis.

AGENCY PRELIMINARY RESPONSE

The Department agrees with the finding. The Department informed us that this area is considered the lowest work priority. Assisting taxpayers in resolving a balance, explaining payment options or assessment reasons, and processing lien or levy releases are all regarded as higher priority work. In addition, actions needed to support collection activities on accounts that are still within the collection statute of limitations also have a higher priority. Periodically, write-offs are worked on as a project.

The Department informed us that overtime has been approved to reduce the number and dollar value of the accounts still on the system that are beyond the collection statute of limitations. A normal part of the collection operation is to continue to pursue opportunities for efficiencies both in the area of write-offs and overall collection operations.

Glossary of Acronyms and Terms

effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical with the minimum amount of resources.
MARCS	Michigan Accounts Receivable Collection System.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.