



April 13, 2009

Honorable Denise Moreno Ducheny, Chair
Joint Legislative Budget Committee
Senate Budget and Fiscal Review Committee

Honorable Noreen Evans, Chair
Assembly Budget Committee

Honorable Christine Kehoe, Chair
Senate Appropriations Committee

Honorable Kevin de Leon, Chair
Assembly Appropriations Committee

Report per Government Code Section 13292.5

Attached is the second annual report prepared pursuant to Government Code (GC) Section 13292.5, which requires the Director of Finance to submit a report on the status of delinquent accounts of seven specified departments. This report presents information on the number and amount of delinquent debts that were owed as of July 1, 2007, the amounts collected on delinquent accounts in 2007-08, and the age of the remaining outstanding debts as of June 30, 2008. As reported last year, based on the definition of delinquent debt in Section 13292.5, a large number of the accounts receivables (AR) for the taxing departments are considered delinquent. As previously reported, this is due to the nature of the tax process. For example, approximately 60 percent of the accounts receivable for the Franchise Tax Board (FTB) are estimates of tax liability because the taxpayer has not filed a return, but FTB has received information indicating that they have a liability. A significant amount of time is required to locate the taxpayer and determine the true liability.

It should be noted that although the receivable amounts reported are very large, the entire amount cannot be viewed as collectible. These amounts include estimated receivables, uncollectible accounts, and receivables which will be collected in the normal course of business.

As a result of the findings from the 2006-07 Delinquent Accounts Report, the Department of Finance established an AR Workgroup to improve administrative procedures and collections on delinquent accounts. Over the past year, the AR Workgroup has evaluated existing AR processes and procedures. The meetings included presentations from the vendor community to present their ideas. The vendors acknowledged that the taxing departments have more collection tools than the vendors, such as the ability to garnish wages, issue liens and levies, etc. The workgroup has made initial recommendations which have been included in a 2009-10 budget change proposal. The recently enacted 2009-10 budget includes funding for two positions at the State Controller's Office to collect and analyze receivable data from more departments and funding to expand the use of private collection agencies.

Over the course of the next year, the AR Workgroup will continue to meet periodically to identify additional improvements to the overall management of the state's receivables, which will include evaluating ways that the state can increase potential revenues, implementing best practices, and collecting additional receivable data from departments.

If you have any questions or need additional information regarding this matter, please call Larry Satter, Supervising Administrative Analyst, at (916) 445-3434, ext. 2143.

MICHAEL C. GENEST

Director

By:



ANA J. MATOSANTOS

Chief Deputy Director

Attachment

This report is submitted to meet the provisions of Government Code (GC) Section 13292.5, requiring annual reporting by the Department of Finance to the Legislature on the status of delinquent accounts receivable (AR) for seven specified departments and the efforts made to collect these accounts in the previous fiscal year. This reporting requirement sunsets on July 1, 2010. The reporting departments are: Franchise Tax Board (FTB), Board of Equalization (BOE), State Lands Commission, Department of General Services (DGS), Department of Motor Vehicles (DMV), Department of Real Estate, and the Department of Corporations.

This report summarizes AR and collection data received from the departments for fiscal year 2007-08. Attachments 1 and 2 provide all data required in GC Section 13292.5. In addition to the data elements required by statute, supplemental data was collected, such as total ARs established, adjustments, and total collections received during 2007-08.

The state's collection procedures are detailed in the State Administrative Manual Section 8776 (et seq). The 2006-07 Delinquent Accounts Report also included a detailed description of the state's collection and discharge procedures.

This is the second year of the reporting requirement. As a result of the findings from the 2006-07 report, the Department of Finance (Finance) established an AR Workgroup to improve administrative procedures and collections on delinquent accounts. The intent of this workgroup is to:

- Develop better information on the existing processes used by departments for collecting accounts receivable.
- Evaluate the effectiveness of these processes, both in terms of total amounts collected and the timeliness of the collections.
- Examine methods used by other governmental agencies and the private sector.
- Identify what can be done to improve existing procedures.
- Estimate how much additional revenue, if any, could be collected with alternative processes.
- Determine what additional resources, if any, would be required to make improvements.

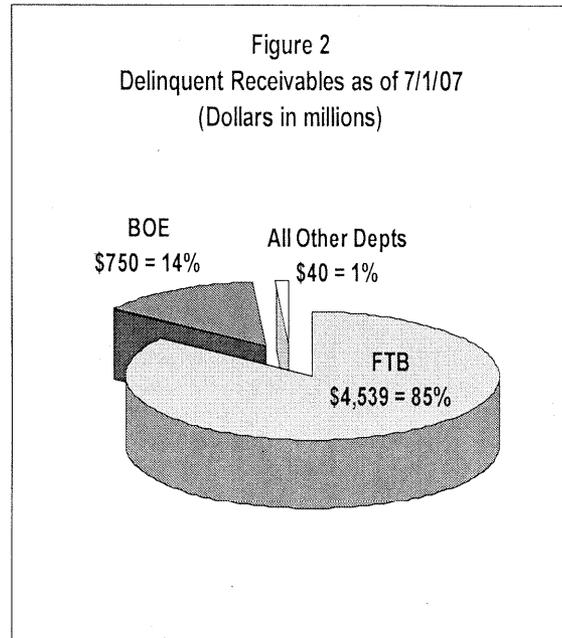
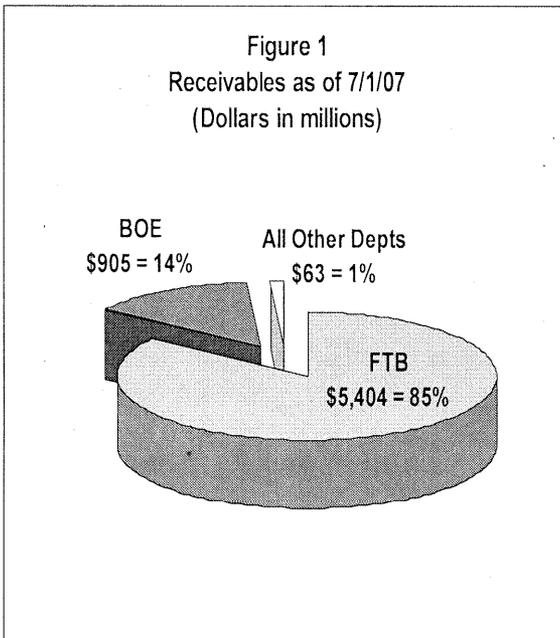
The workgroup has evaluated existing AR processes and procedures, implemented new administrative procedures for locating debtors and for performing reviews of ARs, evaluated and submitted initial recommendations on the feasibility of selling the state's discharged debts or ARs, identified that statewide AR amounts may be misleading, and submitted a budget change proposal to improve statewide AR management.

In addition to the progress made by the workgroup this past year, FTB has also made improvements this year to improve their collection process. In October 2008, FTB began participation in the Federal Treasury Offset Program, which allows FTB to submit income tax debt to the federal government to be offset against federal tax refunds. FTB estimates approximately \$1 million in additional revenue for 2008-09. In addition, FTB is testing a new "best practices" approach to awarding collection contracts with private vendors. The new approach takes into account the fee charged by the vendor and the expected recovery rate to determine the best return to the state. This new approach is being evaluated for its effectiveness in improving the state's collections from private vendors. FTB also added more tax collectors to collect on discharged ARs.

Receivables and Delinquencies as of July 1, 2007

GC Section 13292.5 defines a delinquent account as any loan, accounts receivable, fine, assessment, penalty, or other obligation owed to any agency that is unpaid for 180 or more days after obligation was first due to the state agency.

- The seven departments reported a total of \$6.4 billion in outstanding receivables as of July 1, 2007. Figure 1 displays the percentage of total receivables by department. As reported in the 2006-07 report, receivables for the taxing departments, FTB and BOE, comprise 99 percent of the total. Of the \$6.4 billion, \$5.3 billion were delinquent as defined in GC Section 13292.5. These amounts include approximately \$3 billion in estimated receivables for filing enforcement assessments by FTB. Approximately 39 percent of these estimated receivables will be reduced. Figure 2 displays the percentage of delinquent receivables by department.



- Amounts reported by both BOE and FTB include interest and penalties which have been added to the original AR amount.
- It is common for FTB to have delinquent receivables, as defined by this statute, because of the nature of the receivables. Once a tax assessment is determined, a receivable is established. The debtor then has an opportunity to voluntarily pay, while the receivable remains on the accounting records. If a debtor cannot pay their debt in full, installment agreements may be established. Generally, the average length of an installment agreement is 36 months but not more than 60 months. FTB also turns over some accounts to private collection agencies. In addition, FTB has the ability to garnish wages, levy bank accounts, and issue liens, which may increase the time a receivable remains on the accounting records. FTB also has a large number of receivables that are not subject to normal collections due to statutory limitations, which also increase the time a receivable remains outstanding. Some examples include: (1) Bankruptcies - If a debtor has filed for bankruptcy, FTB is limited to the collection actions that can be taken.

(2) Decedent - FTB must follow probate laws in collecting debts of the decedent. (3) Dual Liability Child Support/Taxes - Debtors may owe both taxes and child support. Child support obligations must be resolved prior to FTB taking collection action on tax debts. (4) Offer in Compromise - FTB may accept compromises for less than the tax amount owed if the taxpayer does not have the money, assets, or means to pay their tax liability. Approximately 60 percent of FTB's receivables are attributable to taxpayers who have not filed tax returns, but for whom FTB has gotten third-party information that indicates they appear to have a liability. FTB prepares estimates of these taxpayers' liability based on available data sources; however, these estimates are subject to a great deal of uncertainty until FTB can locate the taxpayer and convince them to file a return. A very high proportion of these receivables are eventually reduced or adjusted when the taxpayer actually files a late return. FTB reports that tax returns are often filed more than a year after the filing enforcement activities are brought to bear; therefore the estimated receivable may remain in the accounting records for some time.

As of July 1, 2007, FTB's delinquent receivables totaled \$4.5 billion, representing 85 percent of the total delinquent receivables in this report. The \$4.5 billion includes approximately \$3.0 billion in estimated receivables for enforcement assessments. Based on the latest historical averages, it is estimated that 39 percent of these receivables will be reduced because the taxpayer files a return showing they have a lower liability. For purposes of this report, we have applied 39 percent (or \$1.2 billion) to the estimated assessment amount to get a more accurate receivable amount. FTB also discharged \$969 million in receivables in 2007-08 and continues to pursue collection of the remaining \$2.4 billion. In addition, FTB reports that it collects about \$130 million annually on discharged debt. Below is a breakdown of FTB's delinquent receivables:

FTB's Delinquent ARs as of July 1, 2007 (In Millions)	
Installment Agreement	\$325
Collection Agencies	574
Liens, Withholding, Levies	464
Other ¹	2,081
Statutorily Limited:	
Bankruptcies	285
Decedent	64
Dual Liability Child Support/Taxes	528
Offer In Compromise	17
Other Statutorily Limited	201
Total	\$4,539
Adjustment for estimated receivables	(1,200)
Discharged in 2007-08	(969)
Active Collection Inventory	\$2,370

¹ Includes receivables in the first stages of the collection process, and other receivables in various stages of the collection process. Receivables may be satisfied by collections from installment agreements, liens, withholdings, levies, and/or collection agencies. In addition, the collection efforts on the receivable may become statutorily limited.

Other departments may have similar issues, which require payments over multiple years.

Collections in 2007-08

- \$2.78 billion in collections received on ARs in 2007-08.
- \$923 million was collected on \$5.3 billion delinquent receivables. Collections on delinquent receivables increased by \$262 million compared to 2006-07.

Private Collection Agencies – Of the \$89 million turned over to private collection agencies by the FTB, \$2 million was collected. The amount turned over to private collection agencies decreased by \$375 million. FTB had a lapse in contracts with private collection agencies to conduct a six month “best practices” study with the goal of improving the method of awarding contracts and thereby improving collections. This new approach is currently being evaluated for effectiveness.

Adjustments against ARs as of July 1, 2007

Adjustments are made to accounts to accurately reflect AR balances. A large portion of the adjustments reported are for estimated ARs from FTB and BOE.

- ARs were adjusted down by \$1.8 billion by the seven departments in 2007-08.
 - FTB reduced their ARs by \$1.7 billion in 2007-08. Approximately 60 percent of FTB's receivables are attributable to taxpayers who have not filed tax returns. FTB prepares estimates of these taxpayers' liability based on available data sources. A very high proportion of these ARs are eventually adjusted or reduced when the taxpayer files a late return.
 - BOE reduced their ARs by \$97 million in 2007-08, due to estimated billings.

Discharge from Accountability/Write-offs in 2007-08

If all reasonable collection efforts do not result in payment, departments may request discharge of their ARs as described in SAM 8776.6. Most of these ARs are beyond the statute of limitations for collections.

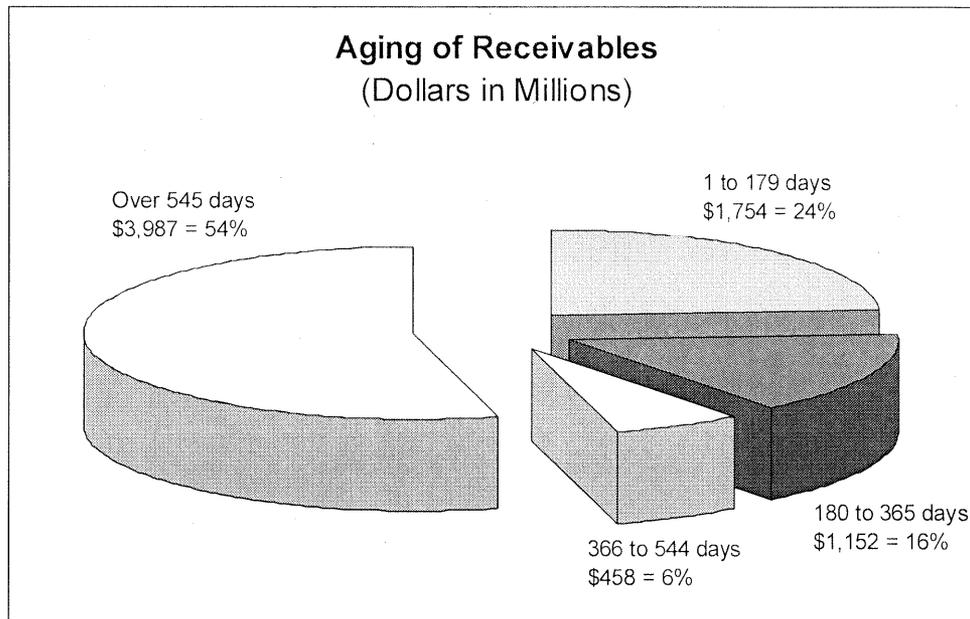
- \$1 billion was discharged by these seven departments in 2007-08.
- Of the \$1 billion discharged, \$969 million was for FTB and \$63 million was for BOE. FTB continues to monitor and collect on discharged debt. FTB reports that it collects about \$130 million annually on discharged debt. Other departments continue to receive collection on discharged debt.
- DMV discharged \$19 million in dishonored checks, which the majority was beyond the statute of limitations.

In September 2008, the State Administrative Manual was revised to require departments to review their ARs at least quarterly to identify ARs for discharge. If departments have identified receivables for discharge, departments are required to submit applications to the SCO to discharge these ARs.

Receivables as of June 30, 2008

- The seven departments reported a total of \$7.4 billion in outstanding receivables as of June 30, 2008. This includes approximately \$3 billion in estimated receivables for filing enforcement assessments by FTB. Receivables for the taxing departments, FTB and BOE, comprise 99 percent of the total.
- FTB's ARs as of June 30, 2008 increased by 13 percent compared to the balance as of June 30, 2007. The primary reason for the increase is due to timing difference in assessments for corporation tax filing enforcements. These assessments are normally issued soon after the beginning of a new fiscal year to allow sufficient time for resolution before the end of the fiscal year. However, FTB issued these assessments later in the year to focus on the implementation of a pilot program on personal income tax assessments.
- Due to various administrative procedures and the nature of the receivables, the age of the receivables may not be a determining factor when assessing their collectability.
- ARs over 545 days decreased by 11 percentage points over the last year.

The figure below displays receivables categorized by the age of the receivable.



CONCLUSION

After conducting the analysis on the data received for 2007-08, we determined that the data is consistent with the 2006-07 data received from the seven departments. Although the seven departments reported \$7.4 billion in ARs as of June 30, 2008, the entire amount cannot be viewed as collectible. When looking at these amounts, it is important to note that the amounts include estimated ARs, uncollectible accounts, and ARs for which a portion will be collected in the normal course of business. FTB and BOE, which comprise 99 percent of the ARs in this report, have estimates included in their AR balances. Approximately 60 percent of FTB's ARs are estimates of tax liability because the taxpayer has not filed a return, but FTB has information indicating that they have a liability. Historically, 30 to 40 percent of FTB's estimated assessments are reduced because the taxpayer has filed a late tax return showing that their liability was less than FTB estimated. Departments may also have uncollectible accounts included in their AR balances because they have not yet processed applications for discharge or have not received approval to discharge uncollectible ARs.

In the past year of meeting with the workgroup, we have learned that there are vast differences in practices, data collection, and nature of accounts receivable in each department and that evaluation of the state's AR management processes and practices is a long-term project. The workgroup has submitted an initial set of recommendations which have been included in a 2009-10 budget proposal. The proposal includes funding for positions to collect and analyze AR data from more departments. In addition, the proposal includes funding to expand the use of private collection agencies. The workgroup has also been evaluating the administrative policies and procedures pertaining to ARs. There have already been updates made to the State Administrative Manual, which should assist departments with their collection efforts and improve the accuracy of the state's financial statements. Finance has also provided training to state employees with information necessary to effectively record and manage their receivables. Over the course of the next year, the AR Workgroup will continue to meet periodically to identify additional improvements to the overall management of AR practices and processes, which will include evaluating ways that the state can increase potential revenues, implementing best practices, and collecting additional AR data from departments.

Data required per GC 13292.5

-A- Department	-B- ARs as of 7/1/07	-C- Delinquent ARs as of 7/1/07	-D- Count of Delinquent ARs as of 7/1/07	-E- Collections Received on Delinquent ARs During 07/08 (Col C)	-F- ARs as of 6/30/08	-G- Count of ARs Discharged	-H- ARs Discharged	-I- Amounts to Collection Agencies	-J- Amts Collected by Collection Agencies
BOE	\$904,639,202	\$750,042,335	105,976	\$49,676,416	\$1,092,324,075	7,307	\$63,197,010	\$0	\$0
FTB	5,403,903,509	4,539,453,728	779,468	864,878,557	6,203,790,667	262,264	968,993,003	89,518,007	2,090,143
Lands Commission	2,619,602	344,979	205	233,899	1,985,866	0	0	0	0
DGS	5,259,524	2,219,015	687	1,025,797	7,489,252	18	6,384	0	0
DMV	52,470,239	36,904,202	124,926	6,381,615	40,369,762	80,211	19,497,963	0	0
Real Estate	1,252,101	176,870	373	10,342	1,025,325	224	17,969	0	0
Corporations	1,551,075	568,936	89	562,648	3,426,597	0	0	0	0
Totals ^{1/}	\$6,371,695,252	\$5,329,710,065	1,011,724	\$922,769,274	\$7,350,411,544	350,024	\$1,051,712,329	\$89,518,007	\$2,090,143

Supplemental Data Collected

Department	ARs as of 7/1/07	Adjustments Against ARs as of 7/01/07	ARs Established During 07/08	Collections Received on ARs During 07/08	ARs Discharged During 07/08	ARs as of 6/30/08
BOE	\$904,639,202	-\$96,637,446	\$732,004,668	-\$384,485,339	-\$63,197,010	\$1,092,324,075
FTB	5,403,903,509	-1,668,920,679	5,679,503,602	-2,241,702,762	-968,993,003	6,203,790,667
Lands Commission	2,619,602	-93,332	11,819,207	-12,359,611	0	1,985,866
DGS	5,259,524	-1,699,158	33,078,065	-29,142,795	-6,384	7,489,252
DMV	52,470,239		117,870,836	-110,473,350	-19,497,963	40,369,762
Real Estate	1,252,101	-9,280	1,185,977	-1,385,504	-17,969	1,025,325
Corporations	1,551,075		7,003,519	-5,127,997	0	3,426,597
Totals ^{1/}	\$6,371,695,252	-\$1,767,359,895	\$6,582,465,874	-\$2,784,677,358	-\$1,051,712,329	\$7,350,411,544

^{1/} Amounts for governmental cost funds only

Aging of Delinquent Receivables as of 6/30/08

	180 to 365 days		366 to 545 days		Over 545 days		Totals	
	Count	Amount	Count	Amount	Count	Amount	Count	Amount
Equalization	27,552	\$124,505,587	19,406	\$64,071,297	79,159	\$686,133,670	126,117	\$874,710,554
FTB	210,320	1,020,870,780	146,215	390,706,104	441,150	3,287,447,016	797,685	\$4,699,023,900
Lands Comm	28	32,901	7	5,433	119	179,002	154	\$217,336
DGS	118	1,261,688	31	107,556	377	1,468,684	526	\$2,837,928
DMV	4,980	4,352,543	8,496	2,674,627	44,405	11,486,108	57,881	\$18,513,278
Real Estate	72	24,169	101	108,589	275	114,899	448	\$247,657
Corporations	636	1,010,700	59	239,631	36	60,960	731	\$1,311,291
Totals 1/	243,706	\$1,152,058,368	174,315	\$457,913,237	565,521	\$3,986,890,339	983,542	\$5,596,861,944

NOTES

- As defined in GC 13292.5, delinquent accounts means any loans, accounts receivable, fines, assessments, penalties, or other monetary obligation owed to a state agency that is unpaid for 180 or more days after the obligation was first due to the state agency. However, due to system limitations, some departments age the receivable based on the invoice date.
- Due to the nature of receivables for the tax agencies, FTB and BOE, it is not uncommon for them to have delinquent ARs. It may take several months for the debtor to pay their liability.
- The discharge process can be very lengthy and labor intensive, taking several months, which may temporarily overstate receivables. However, in September 2008, the State Administrative Manual was revised requiring departments to review their ARs no less than quarterly to identify receivables for discharge. In addition, the departments responsible for reviewing discharge claims will be processing them more frequently.