

February 26, 2010

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 third 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, 2008, the amounts collected on delinquent accounts in 2008-09, and the age of the remaining outstanding debts as of June 30, 2009. As reported last year, based on the definition of delinquent debt in GC Section 13292.5, a large number of the accounts receivables (AR) for the taxing departments are considered delinquent. Also previously reported, this is due to the nature of the tax process. For example, approximately 52 percent of the AR 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. In addition, the increase in receivables can be partially attributed to the fall in economic output and negative growth in 2009.

In spite of the economic impact, departments such as FTB and Board of Equalization (BOE) have made strides to improve revenue collections. The FTB's revenue projections for participating in the Federal Treasury Offset Program for the next three fiscal years beginning 2010-11 are \$6 million, \$80 million, and \$113 million. For 2010-11, FTB is requesting funding of \$8.2 million and 105 positions in the Governor's Budget to maximize the AR collections efforts. The additional resources will allow the department to maximize the collection efforts and decrease the AR balance. The estimated revenue generated from this proposal is \$52.5 million in 2010-11 and \$111 million in 2011-12. The Governor's Budget also provides funding of \$14.7 million and 158 temporary positions to address FTB's revenue workload backlog. This proposal will generate \$50 million in revenues in 2010-11. The BOE continues to be proactive in improving taxpayer compliance such as enhancing their identification and collections of sales and use tax evasion through the Tax Gap Program implemented in 2008-09, and improving enforcements efforts on compliance on all taxes and fees. For BOE, the Governor's Budget proposes \$13.5 million funding for staffing to maximize revenue collection, generating \$90 million in revenues for 2010-11.

As a result of the findings from the 2006-07 Delinquent Accounts Report, the Department of Finance (Finance) established the Statewide AR (SAR) Workgroup to improve administrative procedures and collections on delinquent accounts. Subsequently, the workgroup's initial recommendations were submitted in the 2009-10 Budget Change Proposal and approved by the Legislature. A significant recommendation is for the collection and centralization of more extensive and relevant AR data to allow for a more accurate assessment of the state's AR management practices. The State Controller's Office (SCO) received two limited-term positions for this purpose and is currently gathering AR data from departments. The SCO will review and analyze the AR data, and will work with Finance to provide quarterly status reports to the SAR Workgroup. A final report of the findings and recommendations for improving statewide AR practices and enhancing revenue opportunities will be presented by SCO to Finance by December 31, 2010.

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.

ANA J. MATOSANTOS  
Director  
By:

/s/ Todd Jerue

TODD JERUE  
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 prior fiscal year. The reporting departments are: Franchise Tax Board (FTB), Board of Equalization (BOE), State Lands Commission, Department of General Services, Department of Motor Vehicles, Department of Real Estate, and the Department of Corporations.

This report summarizes AR and collection data received from the departments for fiscal year 2008-09. 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 2008-09. The state's collection procedures are detailed in the State Administrative Manual Section 8776 (et seq).

This is the third year of the reporting requirement. As a result of the findings from the 2006-07 report, the Department of Finance (Finance) established a Statewide AR (SAR) Workgroup to improve administrative procedures and collections on delinquent accounts. Subsequently, Finance submitted a Budget Change Proposal (BCP) for 2009-10 to implement initial recommendations by the SAR Workgroup. The BCP was approved by the Legislature and included several components:

- Limited funding to pay for the contingency fees of private collection agencies.
- Funding for two limited-term positions for the State Controller's Office (SCO) to collect and analyze accounts receivable data from all departments.
- Statutory change to allow departments to charge a reasonable fee, not to exceed the actual costs incurred by the department, to recover collection costs on past due ARs (GC Section 16583.1).
- Statutory change to increase the dollar limit from \$250 to \$500 that departments can internally discharge ARs once authorization is provided by the Victim Compensation and Government Claims Board (GC Section 13943.2)

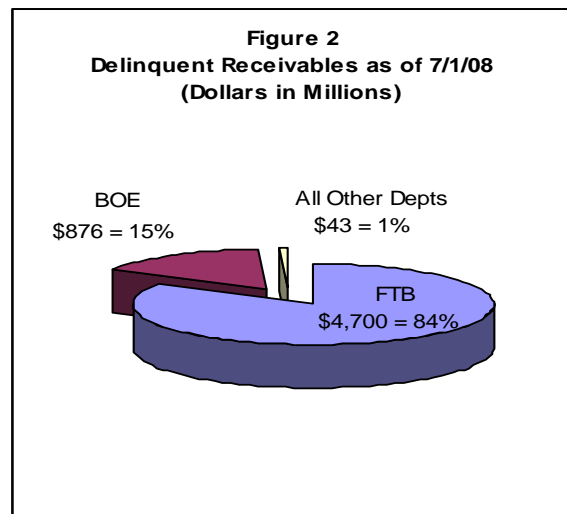
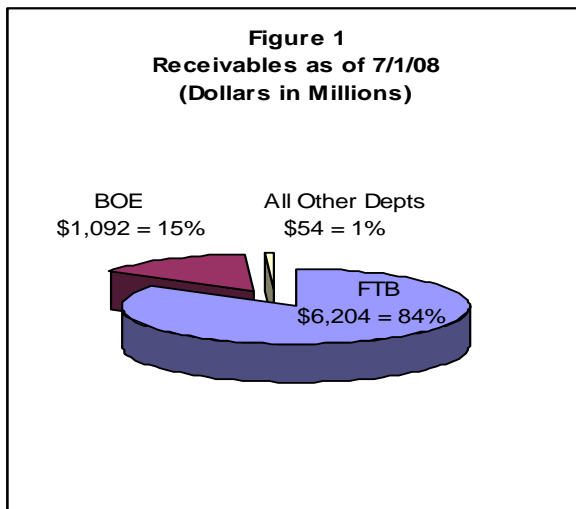
The Accounts Receivable Toolkit was also developed to improve statewide AR procedures and collection practices. This Toolkit, available on the Finance website, provides departments with guidelines and information for managing their ARs such as measures to prevent ARs, best practices for collections, managing employee ARs, accurate accounting of ARs, and discharge from accountability.

As noted in last year's report, 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. Actual revenue collected through this process for 2008-09 was \$2.7 million, surpassing the initial estimate of \$1 million. FTB's revenue projections for the Federal Treasury Offset Program for the next three fiscal years beginning 2010-11 are \$6 million, \$80 million, and \$113 million.

Receivables and Delinquencies as of July 1, 2008

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 \$7.4 billion in outstanding receivables as of July 1, 2008. Figure 1 displays the percentage of total receivables by department. As reported in previous years, receivables for the taxing departments, FTB and BOE, comprise 99 percent of the total. Of the \$7.4 billion, \$5.6 billion were delinquent. These amounts include approximately \$3.3 billion in estimated receivables for filing enforcement assessments by FTB. Approximately 34 percent of these estimated receivables will be reduced (\$1.12 billion). Figure 2 displays the percentage of delinquent receivables by department.



- 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 52 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, 2008, FTB's delinquent receivables totaled \$4.7 billion, representing 84 percent of the total delinquent receivables in this report. The \$4.7 billion includes approximately \$3.3 billion in estimated receivables for filing enforcement assessments. Based on the latest historical averages, it is estimated that 34 percent of these receivables will be reduced because taxpayers file a return showing they have a lower liability. For purposes of this report, we have applied 34 percent (or \$1.12 billion) to the estimated assessment amount to get a more accurate receivable amount. FTB also discharged \$1.14 billion in receivables in 2008-09. In addition, FTB reports that it collects approximately \$130 million annually on discharged debt.

Below is a breakdown of FTB's delinquent receivables:

<b>FTB's Delinquent ARs as of July 1, 2008 (In Millions)</b>	
Installment Agreement	\$360
Collection Agencies	232
Liens, Withholding, Levies	531
Other <sup>1</sup>	2,449
Statutorily Limited:	
Bankruptcies	324
Decedent	45
Dual Liability Child Support/Taxes	603
Offer In Compromise	21
Other Statutorily Limited	133
Total	\$4,698
Adjustment for estimated receivables	(1,120)
Discharged in 2008-09	(1,140)
Active Collection Inventory	\$2,438

<sup>1</sup> 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.

- Amounts reported may include interest and penalties which have been added to the original AR amount.

- BOE reported a significant increase in sales and use tax receivables due to an increase in non-final, new billings from 2007-08 to 2008-09. The number of collection staff remained relatively the same during this period. A taxpayer has 30 days from the date BOE issues a notice of determination, or billing, to appeal the amount owed. After 30 days, a receivable is established; however, the amount may be subject to adjustment due to the appeals process which can take up to several years to complete. During the appeals process, the receivable is generally considered non-final.
- Other departments may require payments over multiple years.

Collections in 2008-09

- \$2.71 billion in collections received on ARs in 2008-09.
- \$674 million was collected on \$5.6 billion delinquent receivables.
- \$1.7 million was collected on the \$355 million in ARs submitted to private collection agencies.

Adjustments against ARs as of July 1, 2008

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 \$2.2 billion as of July 1, 2008.

Discharge from Accountability/Write-offs in 2008-09

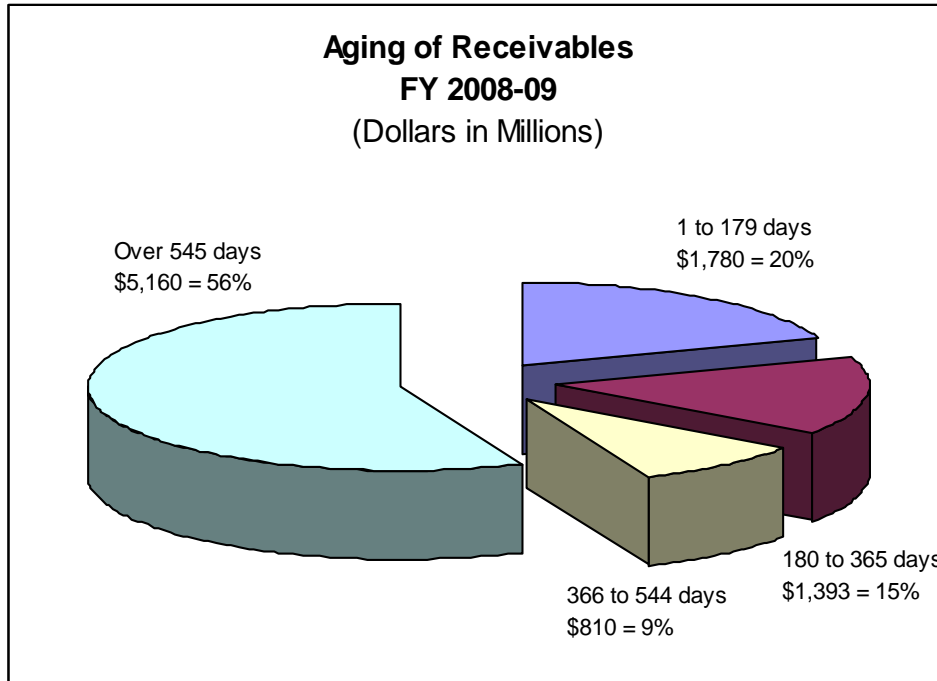
If all reasonable collection efforts do not result in payment, departments may request discharge of their ARs as described in SAM Section 8776.6. Most of these ARs are beyond the statute of limitations for collections.

- \$1.3 billion was discharged by these seven departments in 2008-09.
- Of the \$1.3 billion discharged, \$1.1 billion was for FTB and \$110 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 collections on discharged debt.

Receivables as of June 30, 2009

- The seven departments reported a total of \$9.1 billion in outstanding receivables as of June 30, 2009. This includes approximately \$3.3 billion in estimated receivables for filing enforcement assessments by FTB. Receivables for the taxing departments, FTB and BOE, comprise 99 percent of the total.
- ARs established during 2008-09 is \$8 billion compared to \$6.6 billion established during 2007-08; however, collections received on ARs for 2008-09 is consistent with prior year collections.

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



- FTB’s ARs as of June 30, 2009 increased by 24 percent, or \$1.47 billion, compared to the balance as of June 30, 2008. FTB filing enforcements for personal income taxes and business entities have increased 28 percent, resulting in a \$1 billion increase in ARs. Data provided by FTB indicated more accounts are entering their AR system; however, fewer are being resolved as quickly as in the past. In addition, collecting on accounts is becoming more difficult as more accounts are being pursued by involuntary collection. Accounts become involuntary collection when the taxpayer fails to comply with FTB notices requesting payment and/or a tax return. Legal actions such as withholding orders and wage assignments are taken to collect the balance due.
- FTB also reports two proposals in the Governor’s Budget for “Revenue Restoration” and “Accounts Receivable Growth” in effort to address revenue workload backlogs and the rising AR inventory balance. Funding for these two proposals is \$23 million with an estimated \$102 million in revenues for 2010-11.
- For BOE, the Governor’s Budget proposes \$13.5 million funding to maximize revenue collection, generating an estimated \$90 million in revenues for 2010-11.
- 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.

## **CONCLUSION**

The seven departments reported \$9.1 billion in ARs as of June 30, 2009; however, 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 52 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.

Based on the SAR Workgroup recommendations, improvements have been implemented in 2009-10, such as statutory changes in the AR discharge amount threshold from \$250 to \$500 and allowing departments to charge a reasonable collection fee on past due ARs. In addition, the AR Toolkit provided on Finance's website is a valuable resource available to state departments. Also, limited funding is provided to pay for private collection agencies fees. An estimated net gain of \$19.8 million in revenues may be collected with this mechanism. The proposal is currently being implemented with a number of departments undergoing the contractual process. Finance will monitor the increased use of private collection agencies to ensure the continued need for statewide funding. Lastly, the SCO is provided with two limited-term positions to collect and analyze AR data from departments. The collection of more extensive and relevant AR data from state departments will provide a centralized collection of AR data to monitor, identify and implement actions that can be taken to improve statewide revenues.

The SCO has recently notified departments of the new reporting requirements. The AR data will have more data elements with departments required to provide details on their AR characteristics and the extent of their collection efforts. The SCO will review and analyze the departments' AR data, and will work with Finance and provide quarterly status reports to the SAR Workgroup. A final report of the findings and recommendations for improving statewide AR practices and enhancing revenue opportunities will be presented by SCO to Finance by December 31, 2010. The AR data collected by the SCO will allow for continued monitoring and diligent oversight of the receivables and improve the state's collections. The SAR Workgroup and Finance will continue to meet to identify areas of improvement, review the recommendations made in the SCO's report, and evaluate potential ways to increase the state's revenue.



Data required per GC 13292.5

-A-	-B-	-C-	-D-	-E-	-F-	-G-	-H-	-I-	-J-
Department	ARs as of 7/1/08	Delinquent ARs as of 7/1/08	Count of Delinquent ARs as of 7/1/08	Collections Received on Delinquent ARs During 08/09 (Col C)	ARs as of 6/30/09	Count of ARs Discharged	ARs Discharged	Amounts to Collection Agencies	Amts Collected by Collection Agencies
BOE	\$1,092,424,076	\$875,831,769	122,299	\$44,293,485	\$1,406,240,133	6,426	\$110,148,008	\$0	\$0
FTB	6,203,836,964	4,699,670,532	797,843	622,963,497	7,673,847,778	197,073	1,138,624,273	354,957,729	1,652,478
Lands Commission	1,985,866	217,336	154	21,226	2,573,233	0	0	0	0
DGS	7,489,252	2,837,928	526	1,509,407	3,947,842	3	11,660	0	0
DMV	40,369,762	38,011,241	138,092	5,442,392	45,248,608	36,861	13,966,593	0	0
Real Estate	1,025,325	247,658	448	15,833	4,778,372	230	23,425	0	0
Corporations	3,426,597	1,983,832	1,139	36,903	6,800,450	0	0	0	0
<b>Totals <sup>1/</sup></b>	<b>\$7,350,557,842</b>	<b>\$5,618,800,296</b>	<b>1,060,501</b>	<b>\$674,282,743</b>	<b>\$9,143,436,416</b>	<b>240,593</b>	<b>\$1,262,773,959</b>	<b>\$354,957,729</b>	<b>\$1,652,478</b>

Supplemental Data Collected

Department	ARs as of 7/1/08	Adjustments Against ARs as of 7/1/08	ARs Established During 08/09	Collections Received on ARs During 08/09	ARs Discharged During 08/09	ARs as of 6/30/09
BOE	\$1,092,424,076	-\$113,323,008	\$958,795,636	-\$421,508,563	-\$110,148,008	\$1,406,240,133
FTB	6,203,836,964	-2,109,886,107	6,852,115,930	-2,133,594,735	-1,138,624,273	7,673,847,778
Lands Commission	1,985,866	-136,851	20,890,302	-20,166,084	0	2,573,233
DGS	7,489,252	-1,338,417	26,003,082	-28,194,415	-11,660	3,947,842
DMV	40,369,762	0	116,257,853	-97,412,414	-13,966,593	45,248,608
Real Estate	1,025,325	-5,888	10,566,809	-6,784,449	-23,425	4,778,372
Corporations	3,426,597	0	8,673,362	-5,299,509	0	6,800,450
<b>Totals <sup>1/</sup></b>	<b>\$7,350,557,842</b>	<b>-\$2,224,690,271</b>	<b>\$7,993,302,974</b>	<b>-\$2,712,960,169</b>	<b>-\$1,262,773,959</b>	<b>\$9,143,436,416</b>

1/ Amounts for governmental cost funds only

**Aging of Delinquent Receivables as of 6/30/09**

	180 to 365 days		366 to 545 days		Over 545 days		Totals	
	Count	Amount	Count	Amount	Count	Amount	Count	Amount
Equalization	44,475	\$204,896,124	26,299	\$123,952,524	103,638	\$770,687,031	174,412	\$1,099,535,679
FTB	248,720	1,178,322,688	160,652	684,137,685	513,896	4,369,080,726	923,268	\$6,231,541,099
Lands Comm	33	43,964	14	27,773	121	117,282	168	\$189,019
DGS	47	115,420	44	88,651	329	499,276	420	\$703,347
DMV	22,157	7,420,314	9,338	1,844,479	120,018	18,398,902	151,513	\$27,663,695
Real Estate	42	45,730	49	175,292	152	207,656	243	\$428,678
Corporations	1,155	1,889,321	150	264,986	556	762,335	1,861	\$2,916,642
<b>Totals 1/</b>	<b>316,629</b>	<b>\$1,392,733,561</b>	<b>196,546</b>	<b>\$810,491,390</b>	<b>738,710</b>	<b>\$5,159,753,208</b>	<b>1,251,885</b>	<b>\$7,362,978,159</b>

**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 department that is unpaid for 180 or more days after the obligation was first due to the state department. However, due to system limitations, some departments age the receivable based on the invoice date.
- Due to the nature of receivables for the taxing departments, FTB and BOE, it is not uncommon for them to have delinquent ARs. It may take several months for the debtor to pay his liability.
- The discharge process can be very lengthy and labor intensive, taking several months, which may temporarily overstate receivables. However, the State Administrative Manual was revised in September 2008 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.