MINNESOTA · REVENUE

Improving Minnesota State Debt Collection

Study and Recommendations

presented to the Governor and Legislature
of the State of Minnesota

February 15, 2006

This report was prepared in accordance with the Laws of Minnesota 2005, Chapter 156, article 1, section 15, subdivision 3.

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Introduction

Purpose of the study

The 2005 Minnesota Legislature directed the Minnesota Department of Revenue to prepare a study of state and local government practices for collecting debt, and present it to the Governor and Legislature by February 15, 2006.

The legislation directs the Commissioner of Revenue, in consultation with other state agencies and local units of government, to develop recommendations for:

- consolidating and coordinating the collection of debt owed to governmental units;
- eliminating the fragmentation of contacts from government agencies with debtors owing such debts; and
- reducing the cost of collecting debt owed to governmental units.

To develop recommendations for improving government debt collection processes, this report:

- evaluates the status of debt collections for state[1] debt;
- identifies areas where collection processes and tools can be used more effectively; and
- identifies ways in which to make the process of paying delinquent debts more user-friendly and understandable to the debtor.

Faced with increased fiscal pressures, state and local governments must find more efficient ways to deliver public services, including the collection of debts. Governor Pawlenty's "Drive to Excellence" project has identified numerous opportunities to streamline agency business processes to improve the delivery of services and reduce costs. While consolidated debt collection is not part of the initial phases of the current Drive to Excellence effort, it is consistent with the project's goals of providing better public services at lower cost.

Methodology

Information on current state agency collection practices was obtained through surveys and interviews. Agencies were asked to provide information about the tools and techniques they use in collecting debts owed them, including estimates of their costs of collection, return on investments in collections, and the number of employees engaged in the collection process (FTE).

In November 2005, surveys were sent to 25 agencies. Of that number, 18 responded. Site visits were conducted at selected agencies.

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[1] This report focuses on the collection of state agency debt. Many of the issues and recommendations might also apply to the collection of local government debt. Although the legislation directed that this study also evaluate city and county debt, the large number of local units of government, their diversity, and study time constraints made that impossible. This study recommends that the potential for state collection of local government debt be explored separately, and that a pilot project be created to identify issues and opportunities for more efficient collection of local government debt.

2. Data collected from the agencies was compared to agency data sent to the Department of Finance and reported in their June and/or September 2005 reports.

As part of our research, we looked at industry-standard debt collection principles. Those principles included:

- Have aggressive but fair programs to recover delinquent debts.
- Promote the resolution of delinquencies as quickly as possible since the ability of an agency to collect its delinquent debts decreases as the debt ages.
- Adhere to data practice policies by protecting debtor information.
- Utilize available tools to effectively and efficiently collect the debt.

How state agency debt is currently collected

Although all agencies are required[2] to send debts older than 121 days to the Department of Revenue, there are, in effect, two different collection systems: the methods used by state agencies before debt is referred to Revenue, and the system established by the Department of Revenue for collecting non-tax debt.

Self-managed collection by state agencies

Agencies do not use a common, best-practices approach to debt collection. Collection practices for non-tax debt vary widely across state agencies. Not all state agencies refer their debt to the Department of Revenue's Collection Division, and some refer only a portion of their debts.

The table below illustrates the degree of non-uniformity in non-tax debt collection. Of the 18 agencies that responded to the survey on collection practices, 14 listed a combined total of 17 collection tools (not including "other."). One agency reported using eight tools; four listed none.

Collection tool	Number of agencies using
Personal contact	2
Payment plans	3
Revenue recapture	4
Negotiated settlement	1
Judgments	3
Insurance claims	1
Dept. of Revenue referral	5
Invoices	3
Send past due notices	3
Phone calls	3
File liens	4
Add late penalty payments	1
File bankruptcy claims	1
Send dunning letters	2
Conciliation Court	2
Refuse additional services	1
License revocation	1
Other	6

The current requirement to refer debts to the Collection Division is not enforced. According to statute, delinquent debts older than 121 days are to be referred to the Collection Division. However, there are no consequences for the agency that does not refer its debt to Revenue.

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2 Minnesota Statutes 16D

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Referrals to the Department of Revenue

The Department of Revenue's Collection Division has collected non-tax debt on behalf of other agencies since 1994, when legislation provided for a centralized debt collection service within the Department of Revenue.[3] Some agencies use the Department of Revenue's collection service for all debt; others refer selected debts to Revenue; still others do not refer any of their debts to the Department of Revenue.

At the time of this report, the Department of Revenue Collection Division's inventory of state agency debt was $298 million. For comparison, the department's tax debt inventory during the same period was $322 million. Within the Collection Division's current inventory of non-tax debt, 40 percent of the debtors also have a debt with the Department of Revenue or have at least two debts with different agencies and debt types. For example, a debtor may have debts with Hennepin County and Revenue, or with Ramsey County and MNSCU.

Collection tools and techniques

The department has statutory authority to use a broad range of tools for collecting debt, including:

Filing of liens – A lien is a claim or encumbrance against real or personal property for the payment of a debt.

License clearance – A program that allows the revocation or denial of any license needed to do a professional service.

Revenue recapture – Takes the refunds of individual debtors and applies them to debts they owe a Minnesota state or local agency.

Offer in compromise – An agreement to accept partial payment of a tax debt in order to settle an account.

Payment agreements – An agreement between the debtor and the department stating the amount owed and repayment requirements agreed to.

Seizure of personal and real property – Forcibly taking legal possession of a debtor's real or personal property.

Bank levies – A legal action that orders a financial institution to withdraw funds from a debtor's account to pay a debt.

Wage levies – A legal action that orders an employer to withhold a portion of a debtor's wages to pay a debt.

Vendor set-off – A program that intercepts funds payable to a business or individuals who are vendors of the State and have a state debt.

Electronic payments – A payment made online via the Internet, by phone, or by electronic funds transfer (EFT).

Credit/debt card payments for business and individuals – Debtors can use these forms of payment to pay their delinquent debt.

Referrals to private collection agencies – Referrals are made when all other means of collecting have been exhausted.

Lottery prize intercept –winnings of over $599 may also be intercepted and applied to delinquent taxes and debts.

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[3] The enabling legislation referred to this service as the Minnesota Collection Enterprise, or MCE. However, the Department of Revenue's non-tax debt collection activities are no longer administered separately from tax debt activities. (For clarity, this report will refer only to the Department of Revenue's Collection Division, or simply the Collection Division.)

Debt referral

Electronic referrals account for 98 percent of the debts referred to the Collection Division. State agencies refer debts by means of:

- Access databases.
- Spread sheets.
- Inventory databases.
- Automated files from accounting systems.

Agency reporting

The referring agencies receive monthly inventory reports that provide information on closed cases, inventory balance, balance changes, new debts, and payment summaries.

Debtor resources

Debtors are able to set up payment plans, make payments by credit or debit card, or make a one-time payment via the department's website. Payment history is not available.

Fees

When the debt is referred, a statutory fee of 15 percent of the debt is imposed. An additional 10 percent fee is imposed if resolving the debt requires action beyond letters and phone calls. These fees are charged to the debtor and placed in the state's general fund.

Current problems

We identified problems in three areas: in ensuring the integrity of information regarding the debt and debtor ("authentication"); in how agencies interpret and report accounts receivable data; and with the level of discretion that state agencies have in determining when to refer debt.

1. Debt/debtor authentication not consistently reliable

"Debt/debtor authentication" ensures the accuracy of information regarding both the debtor and the debt. An authenticated debt is one where the debtor, the debt type, and the amount owed have been reliably identified.

Authenticating debts and debtors is problematic for some agencies. In the past, Revenue provided the service of looking up social security numbers based on the debtor information provided by the referring agency. This practice was discontinued because the difficulties of cross-matching records led to an unaccepably high error rate. Billing the wrong person undermines citizen confidence in state government. Other consequences can include:

- The incorrect individual's refund is offset.
- Hardship is created for the wrong individual.
- Disclosure violations result from contact with the wrong individual.
- Enforced collection action is taken against the incorrect individual or business.
- Once the incorrect individual is attached to a debt in the Revenue system, more errors are likely to occur, with additional debts being assigned to the incorrect individual.

Over 70 percent of the agencies currently referring debt to the Collection Division had debtor authentication rates of 94 percent or better. Those agencies accounted for 89 percent of the total debts referred.

2. Tracking and reporting delinquent accounts receivable

Our survey responses indicate a wide variation in how agencies gather collection information and track delinquent accounts receivable. Some use the information reported to the Department of Finance. Two agencies do not track the age of their debts.

The Collection Division had non-tax debt totaling $298 million at the time of this report, yet survey respondents reported only $13.1 million. We attribute this discrepancy to the lack of a common understanding of what is meant by "delinquent debt."

In fact, some agencies had more delinquent debt at the Collection Division than their survey responses indicated. Others listed more delinquent debt on their survey response than they have at the Collection Division. Other findings:

- Some agencies did not include debts greater than 121 days on the accounts receivable survey, but did include them on the finance report.
- Many agencies had numbers for uncollectible debt on the accounts receivable

survey, but that information was not reflected in the figures reported to the Department of Finance in the “doubtful” section. Some of the available accounts receivable for debt collection reported to finance is overstated.

Incompatible accounts receivable systems

The lack of uniform reporting may result from the lack of consistent accounts receivable systems used by state agencies. Some have old mainframe systems that are in need of an upgrade. Agencies using old mainframe systems include Revenue and DEED Unemployment Overpayments. Some, including MnSCU Loan Services and Homeland Security, use purchased software. Others have hired companies to come in and build their systems. This category includes DEED Unemployment Insurance Taxes, DNR, Agriculture, and DHS Child Support. A few of the smaller agencies rely on access databases or excel spreadsheets for their accounts receivable systems. Finally, 12 state agencies use the Minnesota Accounts Procurement System Accounts Receivable Sub System (MAPS ARS).

Inadequate information on costs of collecting debt

Minnesota lacks an enterprise-wide method of measuring return on its collection investments. Developing estimates for overall statewide cost to collect debt or return on investment is extremely difficult, due to lack of information. Survey responses indicate that most agencies do not calculate their return on investment (ROI) or cost to collect. Where information was provided, survey responses revealed inconsistencies in tracking investments associated with collecting debt. Some examples:

- For cost to collect, one agency reported only Department of Revenue fees, even though it also reported some FTEs dedicated to collecting debt. No ROI information was provided.
- For another agency, cost to collect included salary and fringe benefits for a person working on collecting the debt within the agency.
- Information on ROI for another agency included only a dollar amount to collect restitution.
- Cost to collect for one agency was based on four hours assigned to collecting debt bi-weekly. ROI was measured by delinquent debt amount less the uncollectible amount.
- Cost to collect for another was one FTE salary.
- No information was reported on cost to collect or ROI. Respondents added comments such as “not knowable until well into the process for each individual case,” or “Too minimal to report.”

3. Inconsistent debt collection practices

Statewide debt collection for Minnesota is fragmented and inefficient. The law as it stands lacks clarity and results in a hodgepodge of collection procedures and practices. As a result:

- state agencies assign debt collection different levels of priority.
- debtors receive varying levels of service to aid them in resolving their debts.
- the Collection Division may lack authority to negotiate with debtors.
- debts may be recalled by referring agencies, resulting in duplication of efforts.
- referring agencies may be collecting on the same debt at the same time.
- payments are often made to the referring agency rather than the Collection Division, resulting in adjustments or unnecessary collection actions.

Recommendations for enhanced debt collection

We recommend a centralized statewide debt collection system, to be administered by the Department of Revenue Collection Division. These recommendations cannot be implemented without law changes.

Centralized state debt collection

We recommend that agency debts be referred 90 days after they are incurred. During the initial 90-day period, the state agency would follow standardized collection procedures. Debts that remain uncollectible at the end of this time would be referred to the Department of Revenue.

Standardized procedures

1. During the 90-day period, the referring agency would send the debtor a letter outlining information about the debt, possible collection actions, collection tools that could be used, and information on how to dispute the debt. The Department of Revenue will provide language for this letter.

2. After the 90-day period, unresolved debts would be referred to the Department of Revenue's Collection Division. The Collection Division would then become fully responsible for handling the collection of the debt. At that point, referring agencies would only become involved in the collection process if the debt or debtor is disputed.

3. The Collection Division would identify appropriate collection tools and techniques, based on best practices and established thresholds. The division would have full authority to make offers in compromise, as appropriate.

4. Debts may be routed to a private collection agency for collection action or held for a certain period of time in order to capture any tax refunds.

5. The Collection Division would send a monthly charge-off and payment report to referring agencies instructing them to reduce their debts in inventory by specific dollar amounts. The Department of Finance would receive a copy of the report.

6. The agency would have to reduce the debt and apply payments on its system. Alternatively, if there were one statewide accounts receivable system, the Collection Division could easily charge off the debt or apply payments, and agencies could focus on other activities within their agency.

Reporting

We recommend that the Collection Division be responsible for reporting collection activity to all referring agencies. Reports would be monthly, and at a minimum would include dollars collected and inventory status. We also recommend the development of a web access tool that would allow agencies to refer debt and view information.

Referring agencies could access their debtor information, including current balances and collection action history. This web-based tool would provide inventory reports, debts loaded, debt balances, and all transactions made to and from the Collection Division. The agency would use this tool to make referrals on-line.

Authentication

In order for appropriate and effective collection actions to occur, all debt and debtors must be authenticated. We recommend law changes to authorize agencies to obtain debtor information at the origination of the debt.

Customer service

Customer contact is an important piece of effective debt collection. The Collection Division would have a call center responsible for providing the debtor with customer service. Proposed hours of operation are 7:00 am to 5:00 pm CST, Monday through Friday.

We also recommend development of a secure, web-based application to allow debtors access to their transaction information. They would be able to view balances, make payments, set up a payment plan, and view their account history.

Fees

We recommend that the current collection fee structure (15 percent, plus an additional 10 percent) be changed to one fixed rate of 17 percent. (Our review of fees actually charged over the past five years revealed an average fee of 17.24 percent). The 17 percent would continue to be charged to the debtor, and would be deposited into the general fund as non-dedicated receipts.

When debts are referred to private collection agencies, those costs would be funded from the collection fees deposited into the general fund. Collection costs recovered would be appropriated to the Minnesota Department of Revenue Collection Division to pay private agencies for their services. Collection costs in excess of private agency fees would remain in the general fund as non-dedicated receipts.

Write-off authority

We recommend a uniform write-off amount of $24.99 for all types of agency debt.

Recalling debts

Having once referred a debt to the Collection Division, the agency would not be able to recall the debt (unless the information regarding the debt or debtor is discovered to be in error). The debt would become the responsibility of the Collection Division.

Distribution of payments

We recommend that payments continue to be applied first to child support debt (if any). We also recommend giving debtors some discretion in determining the allocation of payments to other debts.

Statutes of limitations

We recommend that Minnesota's statutes of limitations be uniform for all types of debt.

10. **State Agency Accounts Receivable System**

The most effective way to streamline debt collection would be to have one statewide accounts receivable (A/R) system used by all agencies.

We recommend that agencies now in the process of developing accounting/AR systems ensure that their new systems are capable of handling all their agency debts. We also recommend that agencies collaborate to build and use the same accounting/AR system. We recommend that the state upgrade the MAPS ARS system currently used by 12 agencies.

Vendor set-off

We recommend the creation of one web-based system for vendor set-off. Before a payment is made to anyone who provides goods or services to the State of Minnesota, this system would check to see if the entity owes money to a state agency. If there is money owing, payments would be applied towards the debt.

Implementation

As with all recommendations, steps must be taken to ensure successful implementation. It is imperative that prior to referral, state agencies:

- Authenticate the identity of the debtor.
- Ensure the accuracy of the debt.
- Provide the debtor with all rights to contest the debt.

Further study

We recommend that the potential for state collection of local government debt be explored separately, and that a pilot project be created to identify issues and opportunities for more efficient collection of local government debt.

Federal debt collection

Our recommendations align with processes used by the federal government to manage accounts receivable. More information about those processes is available at the U.S. Treasury's Financial Management Service (FMS) website: (www.fms.treas.gov).

The Debt Collection Improvement Act of 1996 (DCIA) and other statutes provide tools for administering a centralized program for the collection of delinquent tax and non-tax debts.

Since centralization, the Treasury has sharply increased collections, adding numerous payment streams and categories of debt. FMS consistently collects more than $3 billion each year in delinquent debt.

Other states' collection practices

Research was conducted to find out how other states handle debt collection. The range of duties varied greatly:

- Eleven states use private collection agencies for collection of tax and/or other agency debts.
- Twelve states partner with other state agencies at different levels to collect state debt.
- Five agencies have centralized collection for state agency debt. (Kentucky, New Jersey, Oregon, Utah, and South Carolina).
- All states capture refunds to pay taxes and other agency debts.

Whenever debts are referred for collection to a centralized agency or private collection agency, it is the referring agency's responsibility to validate, authenticate, or verify the debt being referred.

The streamline process is already under way

We also note that, in the course of this study, we identified areas where we could streamline existing procedures, and have begun to implement these improvements:

- Establishing performance standards.
- Focusing on resolving debts quicker.
- Streamlining collection workflow.
- Enhancing technology to provide more statistical data.

12. Conclusion

We believe these recommendations will provide more efficient and effective centralized debt collection service for the State of Minnesota. These recommendations align with the Governor's Drive to Excellence initiative.

The recommendations contained in this report would improve the collection of government debt for:

- debtors, who would benefit from streamlined services;
- state agencies, which would be able to focus resources on activities that support the agency mission rather than on debt collection;
- the State of Minnesota, which would benefit from consistent and accurate measurements of government debt and debt collection.

We are confident that a more efficient and effective process would result in increased debt collections overall.