
Report of the Vermont State Auditor

April 18, 2016

PERSONAL INCOME TAXES

Department of Taxes Collected
About Half of 2013 and 2014
Delinquent PIT, but was Unable
to Assess the Effectiveness of Its
Collection Methods

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Vermont State Auditor
Rpt. No. 16-03

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STATE OF VERMONT
OFFICE OF THE STATE AUDITOR

April 18, 2016

The Honorable Shap Smith
Speaker of the House of Representatives

The Honorable John Campbell
President Pro Tempore of the Senate

The Honorable Peter Shumlin
Governor

Ms. Mary Peterson
Commissioner
Department of Taxes

Dear Colleagues,

One central mission to the Vermont Department of Taxes (VDT) is to collect unpaid tax debt to help ensure compliance with the tax system. Delinquent personal income taxes (PIT) comprised about 41 percent of delinquent taxes due to the State at June 30, 2015. The goal of VDT is to collect this debt in a timely and efficient manner.

We focused our audit on assessing the effectiveness of VDT's efforts to collect delinquent personal income taxes because PIT debt represents a significant portion of total tax debt. VDT provided the State Auditor's Office (SAO) with data extracts from two systems containing information related to delinquent PIT cases created in 2013 and 2014. However, this data had shortcomings that limited our assessment. For example, the data could not be used to determine whether collections were the result of VDT actions or outside collections agencies (OCA), or to assess the extent to which VDT used certain collection methods, because some data were not tracked in VDT's systems.

Based on the data provided by VDT, SAO calculated that VDT collected 57 percent of the amount owed (\$12.9 of \$22.5 million) for 25,478 delinquent PIT cases identified in 2013 and 2014. Our analysis of closed cases showed the potential for increasing collections by shortening the period before active collection commences. That is, VDT allows low dollar cases (less than \$500) 285 days to "self-cure" (e.g., pay-off with no active collection efforts) prior to referring these cases to an OCA. Shortening the time to send a case to an OCA would start active collection sooner and could increase collections.

Additionally, when analyzing the status and age of PIT debt, we found about 1,400 open cases that were on average several hundred days old (between 476 and 490). According to VDT's collection approach, many of these should already have been sent to an OCA. VDT indicated there are processing issues that result in some cases getting "stuck" in the Enterprise Tax Management Processing and Collection system (ETM) and not advancing to the next phase according to the rules established in the system. Furthermore, it's likely that many of the cases that should be referred to an OCA are not being pursued by VDT compliance officers since each officer is assigned, on average, 1,500 cases.

VDT has not assessed the effectiveness of its collection efforts because they 1) had not established performance measures to analyze the department's collection results and 2) had limited reports about which collection methods were used and how much in payments was received as a result of each method. However, VDT has implemented a new system, VTax, for many of its tax types, and PIT is scheduled to be transitioned to this system in December 2016. This new system has better reporting capabilities than ETM and appears to be configured to collect information that will support analysis of collection methods and the payments associated with each method.

This report makes recommendations to VDT regarding 1) decreasing the self-cure period for certain cases; 2) using case data to identify cases with ages that exceed the self-cure period and referring them to an OCA; and 3) ensuring that the incoming integrated tax system, VTax, is configured to track all collection methods utilized by VDT.

I would like to thank the management and staff at the Department of Taxes for their cooperation and professionalism during the course of this audit.

Sincerely,

A handwritten signature in black ink that reads "DOUG HOFFER". The signature is written in a cursive style with all caps.

Doug Hoffer

Vermont State Auditor

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Introduction

The Vermont Department of Taxes (VDT) pursues collection of tax debt to help ensure compliance with the tax system. If not collected, these unpaid taxes accumulate, along with the related penalty and interest charges, to create an inventory of tax debts also known as tax receivables.

Personal income tax (PIT) receivables are the largest component of tax receivables and represent 41 percent of total tax receivables, or \$80.6 million, as of June 30, 2015. According to VDT records, cash collections as a percent of PIT receivables ranged from 20 percent to 30 percent during the periods fiscal year 2013 to fiscal year 2015.

The legislature required VDT to report on collections in January 2014 and to provide an update on the implementation of its new tax system VTax. In addition, effective June 2014, the legislature allowed VDT to make a list of the top 100 delinquent individual taxpayers publically available. According to a March 10, 2015 report from VDT, subsequent to publishing the Top 100 list, \$240,000 has been collected of \$12 million owed by individuals. At VDT's request, statutory changes were made in 2015 to the process for wage garnishment to allow this enforcement tool to be pursued through an administrative process versus the previous requirement to obtain a court judgment and to add an administrative process to pursue bank levies.

In addition to legislative changes to VDT's collection program, the department has pursued modernization efforts, in particular the use of a program to score a taxpayer's likelihood to pay their debt. Commencing in 2012, this score was used to apply the most appropriate collection treatment based on the risk of non-payment. VDT is in the process of implementing VTax, an integrated tax system in which all tax types are supported by the same information technology platform. PIT are scheduled to be transferred to VTax in December 2016.

Because of the significance of personal income tax receivables to overall tax receivables, legislative interest in tax collections, and recent changes to VDT's collection approach, SAO determined to assess the effectiveness of the department's efforts to collect identified delinquent personal income taxes. To perform this assessment, SAO requested that VDT provide a data

extract with information about the date cases¹ were created, current status, close date, and payment information from the Enterprise Tax Management Processing and Collection (ETM) system.

Appendix I contains the scope and methodology we used to address our objectives. Appendix II contains a list of abbreviations used in this report.

¹ Collection cases are established in ETM by taxpayer entity (single or joint filers). Cases may contain multiple obligations, which represent tax liabilities by tax type and by the year the tax was due (e.g., tax period). The VDT ETM extract parameters were designed to include only PIT tax types.

Highlights: Report of the Vermont State Auditor

Personal Income Taxes: Department of Taxes Collected About Half of 2013 and 2014 Delinquent PIT, but was Unable to Assess the Effectiveness of Its Collection Methods

(April 18, 2016, Rpt. No. 16-03)

Why We Did this Audit	Due to the significance of PIT receivables (\$80.6 million as of June 30, 2015), legislative interest in tax collections, and recent changes to VDT's collections approach, SAO determined to assess the effectiveness of VDT's efforts to collect identified delinquent personal income taxes. VDT provided data extracts from two systems, ETM and Advantage Revenue (AR), with information such as the date cases were created, current status, close date, and payment information for cases initiated from January 1, 2013 to December 31, 2014.
Objective 1 Finding	<p>SAO analysis of VDT delinquent PIT collections data shows that as of July 24, 2015 VDT had collected about \$12.9 million, or 57 percent of the original balance due for 25,478 cases that were identified in the period January 1, 2013 through December 31, 2014. While SAO analysis indicates that payments on delinquent PIT debt are occurring, the department has not established key metrics to track and analyze the department's collection performance. It has limited reports with statistics about caseloads, collection methods, and payments, and as a result, the department does not know whether its collections approach is effective.</p> <p>In addition, SAO analysis was limited because VDT's data could not be used to assess whether payments on delinquent PIT debt were the result of the actions of VDT compliance officers or outside collection agencies (OCAs) or to assess the extent to which VDT used various collection methods and which were most effective. This is because 1) some VDT data were not reliable, 2) VDT was unable to provide SAO with data in a form that would allow for assessing which of the department's collection methods are most effective, or 3) data were not tracked in VDT's systems.</p> <p>From analyses SAO was able to conduct, we found that VDT could shorten the time established for self-cure² for some cases and potentially increase the probability of collection by beginning collection efforts sooner for those cases that do not close within the self-cure period. Specifically, low dollar cases (less than \$500) that are referred to an OCA after a self-cure period of 270 days and a 15-day notice period (285 days total), on average close within 126 days. According to the Generally Accepted Industry Collectability Curve,³ at 285 days the probability of collection is about 35 percent, but at 120 days the probability of collection is higher at around 60 percent. As a result, shortening the self-cure period to 120 days could increase the probability of collecting amounts due.</p>

² The self-cure period commences with the date of the first letter that includes notice of the delinquency to the taxpayer, and is generally before active collection is pursued by a VDT compliance officer or an OCA.

³ Source: Commercial Collection Agency Association

Highlights: (continued)

(April 18, 2016, Rpt. No. 16-03)

	<p>We also noted that the average age for 3,853 of 4,246 open cases indicates that many of these cases have exceeded the self-cure period and should already have been sent to an OCA. However, only 1,355 open cases have been referred an OCA. Although ETM is configured with work flow rules designed to move certain cases to OCA once the self-cure period ends, VDT indicated there are processing issues that result in some cases getting “stuck” in the ETM system and not advancing to the next phase according to the rules established in the system. It’s likely that many of the cases that should be sent to an OCA are not being pursued by VDT compliance officers since each of the officers is assigned, on average, approximately 1,500 cases.⁴</p> <p>According to VDT payment data, approximately \$2.4 million of delinquent PIT debt was collected using various offsets subsequent to the taxpayer being notified of the delinquency. However, it’s not possible to determine whether the additional \$10.5 million of payments were the result of the actions of VDT compliance officers, outside collection agencies or taxpayer corrective action in response to a letter or notice. Nor is it possible to determine the extent to which the department utilized its various collection methods or which collection methods were most effective. These limitations are due in part to the configuration of ETM, including lack of fields for collecting some data. It is also because AR is not configured to capture details that would support these kinds of analyses. For example, payments made by taxpayers directly to VDT for cases that are managed by an OCA are not categorized within AR as OCA payments.</p> <p>VDT has implemented a new system, VTax, for many of its tax types, and PIT is scheduled to be transitioned to this system in December 2016. This new system has better reporting capabilities than ETM and appears to be configured to collect information that will support analysis of collection methods and the payments associated with each method. For example, a VTax report is available that shows collections by tax compliance officer with the type of payment and by collection stage (e.g., 1st collection notice, payment plan, etc.).</p>
What We Recommend	<p>We make a variety of recommendations to VDT, such as 1) decrease the self-cure period for low dollar cases of all risk levels and low/medium dollar cases of low and medium risk to 120 and 140 days, respectively, 2) utilize case data in ETM, until PIT is transitioned to VTax, to periodically identify cases with ages that exceed the self-cure period parameters by greater than 15 days and refer these accounts to OCAs, and 3) ensure that VTax is configured to track all collection methods utilized by VDT.</p>

⁴ This figure is based on collection cases for the tax types included in ETM during the period within the audit scope. Cases for tax types that were not in ETM, corporate and business income, were not included in this figure. The average number of cases was based on August 2015 data when there were 10 compliance officers.

Background

The Compliance Division is the enforcement arm of VDT and assists in taxpayer education, performs desk and field audits, and collects delinquent taxes. The section responsible for collection of outstanding tax debt, including delinquent PIT debt, is the Collections Section (Collections). Collections has a section chief, two supervisors, two data analysts, two support staff, and twelve tax compliance officer positions.

The department also contracts with two outside collection agencies (OCAs). OCAs are paid a commission based on tax liability actually collected. Commission percentages range from 19 to 22 percent.⁵

Data relevant to PIT collections resides in multiple IT systems.

- The Advantage Revenue (AR) system maintains all personal income tax return and payment information.
- Information on amounts owed and payments on accounts is electronically transferred from AR to the Enterprise Tax Management Processing and Collection system (ETM). Information regarding PIT collection cases is maintained in ETM.
- The RSI (Revenue Solutions Inc.) data warehouse system uses taxpayer characteristics stored in a data warehouse and the dollar amount due to assign treatment scenarios to each collection case in ETM.

Identification and Notification of Taxes Due

Delinquent PIT debt is identified in several ways. When a tax return is filed, AR runs system checks to determine if the full amount due has been paid or if the return contains any mathematical errors. AR also compares return information to corroborating information from W-2s, 1099s, prior year federal tax returns, and other information stored in the RSI data warehouse.

In addition, AR searches for instances where a return is not filed when one is expected. Using information from the RSI data warehouse, the Vermont

⁵ These contracts expired on February 29, 2016. VDT has signed a contract with one new OCA and expects to finalize a contract with a second OCA. Commission percentages for these new contracts range from 14.9 to 23.0 percent.

Department of Labor, prior state and federal tax returns and other sources, non-filers are identified. When a potential debt has been identified, the Advantage Revenue system sends a letter to the taxpayer (“initial letter sent”) and a collections case is opened in ETM (if one does not already exist). The initial letter from AR contains the amount of debt owed plus any penalties, interest, or fees due, less any previous payments by or credits to the taxpayer. This letter also advises the taxpayer of their right to appeal. During the appeal period, the taxpayer can contest the liability and provide documentation to refute the VDT claim. The taxpayer has 60 days from the date the letter was sent to file an appeal with the VDT commissioner. If the taxpayer does not file an appeal, the amount of the debt becomes fixed⁶ once the appeal period has expired.

Collections Case Management in ETM

Each case in ETM is assigned a “case status,” which identifies where it is in the collections process. When the case is first created in ETM, the case is assigned “new case” status and the case will stay in this status until there is contact from the taxpayer or the VDT-determined self-cure period has expired. The self-cure period is the time VDT allows for taxpayers to settle their debt without collection efforts and varies according to the amount of debt and risk level. Based on the treatment scenario, ETM is programmed to update the case subsequent to the end of the self-cure period to a status that indicates the case will be referred to an outside collection agency (OCA) or be assigned to VDT compliance officers. (A list of status codes is in Appendix III.)

Treatment Scenarios

VDT uses a scoring methodology to determine how collections for delinquent PIT debt should be handled (e.g., length of self-cure period and whether collection will be by VDT or an OCA). The collection approach assigned is based on the risk level associated with a delinquent PIT tax debt and considers the dollar amount of the debt. The risk score assesses the likelihood that a taxpayer will not make payments on their debt. Using information stored in the RSI data warehouse, the score incorporates assessment of taxpayer characteristics such as average bill amount (if taxpayer has prior delinquent tax debt), time since last return filed,

⁶ According to 32 V.S.A. 5887(b), if a taxpayer fails to appeal, the taxpayer is bound by the terms of the notification, assessment, or determination, as the case may be.

bankruptcies, and wage pattern. The dollar level is based on the billed amount of tax due. For example, if a collections case has been determined to be low risk and low dollar, the treatment assigned will be to hold the case for 270 days to allow the taxpayer time to pay the debt (e.g., self-cure). Debts with higher risk and higher dollars have shorter self-cure periods.

After the initial self-cure periods have expired, a secondary treatment comes into effect. Either the case will be transferred to an outside collection agency (OCA) or it will be assigned to an officer to start working the case.

Timing of Collections Cases and Collection Methods

Active collection by tax compliance officers is generally deferred until the end of the self-cure period. The length of time established for self-cure includes the 60-day appeal period except for cases assessed as high risk-high dollar and very high dollar.⁷ Compliance officers are not prevented from working cases during the self-cure period, and can contact taxpayers and use the methods allowed by statute to work to collect the debt.

The Vermont legislature has passed several laws prescribing methods of collecting personal income tax debt. These include use of OCA, liens, and offsets against state and federal tax refunds.

Monitoring Collections, Collections Cases, and Compliance Officers

According to VDT, the primary tool used by Collections to monitor collections cases is the "Collection Case Report," a spreadsheet listing all outstanding debts in ETM (not just personal income tax), sorted from highest dollar to lowest dollar owed. Collections supervisors review the list to ensure that cases are being worked appropriately. Each compliance officer receives the section of the report with their personally assigned cases to review and update if necessary.

Supervisors also use the Collection Case Report to compare from one month to the next changes in cases and changes in balances outstanding. Supervisors monitor compliance officers by listening to how they speak with taxpayers and answering questions. Telephone statistics for each compliance officer are collected and reviewed. Supervisors also review how the officers' documentation for their cases.

⁷ High risk - high dollar and very high dollar have self-cure periods of 10 days.

Personal Income Tax moving to VTax system

VDT has been using multiple primary but separate platforms and a data warehouse to administer 41 unique taxes. All Vermont tax functions, including a collections and billing function, are being consolidated into a new Integrated Tax System, VTax. VDT expects VTax to serve as a catalyst for the review and elimination of manual workflows and operations and to expand and improve reporting capability, among other benefits. Personal Income Tax (phase three) will be deployed in fiscal year 2017 with a go-live expected in December 2016. Once phase three has been completed, it is expected that the ETM system retirement date will be scheduled.

VDT Data Extracts

To assess VDT's effectiveness at collecting delinquent PIT debt, SAO requested an extract of PIT collection cases that opened between January 1, 2013 and December 31, 2014. VDT provided a data extract from a non-production copy of ETM that included 30,433 cases containing 37,483 obligations.⁸ Each obligation is for one tax period, and each case is for one tax entity (individual or married couple). For each case, the extract included such information as the date the case was created, case status at July 24, 2015, tax compliance officer assigned, collection treatment, case closed date (if applicable), and payments through July 24, 2015, among other data points.

Using a combination of computer-assisted auditing techniques and judgmental samples to verify data in the extract to source documentation, SAO determined that some of the data in the ETM extract were sufficiently reliable for audit purposes. These data included the date the case was created and closed, original and current treatment, lien filed date, case status code and current obligation. However, payment data and the date the taxpayer was first notified of a tax delinquency ("initial letter date") were not sufficiently reliable for audit purposes.

As an alternative, VDT provided two extracts directly from AR, which is the original source for the payment data ("payment extract") and initial letter information ("initial letter extract") housed in ETM. The payment extract contained all payments associated with each delinquent PIT tax case, including payments prior to the identification of the delinquency. For example, estimated payments and payments made with tax returns were included in the payment data. To identify collections for delinquent PIT

⁸ Periodically, VDT exports data from the ETM production environment to a staging environment or non-production copy of ETM. This copy is used to run/compile ETM reports.

cases, SAO summarized payments received subsequent to the date of the initial letter, which is the date the taxpayer was notified of the tax delinquency.

Data in the payment extract was sufficiently reliable for audit purposes and most of the data in the initial letter extract were sufficiently reliable. However, the data related to certain cases were missing or of indeterminate reliability. Specifically, all fields in the initial letter extract were blank for 712 cases, and the initial letter sent date was of indeterminate reliability for another 1,449 cases. As a result, SAO excluded payments for the 712 cases from analysis because there was no information regarding the date the taxpayer was notified of the tax delinquency. Payments of \$773,000 for the 1,449 cases were included in SAO's analysis, but these payments may be misstated because the initial letter sent date was of undetermined reliability. The original balance due for the 1,449 cases was \$1,349,000.

More Than Half of Identified Delinquent PIT Debts Collected, but Assessment of VDT's Effectiveness Hindered by Data Limitations

SAO analysis of VDT delinquent PIT collections data shows that VDT collected \$12.9 million⁹ through July 2015 for 25,478 delinquent PIT cases identified in 2013 and 2014. These cases had an original balance due of \$22.5 million.¹⁰

There were an additional 4,955 cases with a total balance due of \$12.4 million identified by VDT as delinquent, but these cases closed without payment and were excluded from the SAO analysis of VDT's collections. Cases close without payment for a variety of reasons. For example, a taxpayer neglects to file the IN-113 schedule for income adjustments, but once this form is filed, it shows the taxpayer does not have delinquent PIT debt. This case would be closed with no payment.¹¹

⁹ SAO excluded payments for 712 cases because the data was not sufficiently reliable for purposes of the audit objective. About \$773,000 is included for 1,449 cases where some of the data provided by VDT were of indeterminate reliability. See VDT Data Extracts in the background section for additional information.

¹⁰ Original Balance Due is the amount of the delinquent PIT debt included in the first letter sent to a taxpayer that provides notification of delinquency. This amount may be adjusted based on taxpayer-provided information and penalties and interest.

¹¹ See Appendix IV for additional examples.

Approximately \$7.2 million is owed for cases that remained open as of July 24, 2015. See Table 1 for additional information regarding balances due and amounts collected for closed and open cases.¹²

Table 1: Number of Closed and Open Cases, Original Balance Due, Amounts Collected, and Balance Due as of July 24, 2015, dollar amounts rounded^a

	Number of Cases	Original Balance Due	Amounts Collected	Balance Due as of 7/24/2015 ^b
Closed Cases	20,947	\$13,205,000	\$10,422,000	\$ -
Open Cases	4,531 ^c	\$9,317,000	\$2,477,000	\$7,169,000
TOTAL	25,478	\$22,522,000	\$12,899,000	\$7,169,000

^a This data is for delinquent PIT cases that were identified during the period January 1, 2013 to December 31, 2014.

^b Balance Due cannot be calculated using Original Balance Due less Amounts Collected because Original Balance Due may be adjusted based on taxpayer-provided information and penalties and interest.

^c There are 285 open cases with \$0 balance due at July 24, 2015.

About \$4.3 million was collected on 19,467 cases that closed during the time VDT describes as the “self-cure” period. Another \$6.1 million was collected for cases that closed subsequent to their self-cure period, and \$2.5 million was collected on cases that remain open as of July 24, 2015.

While the data indicate that payments on delinquent PIT debt are occurring, VDT has not established key metrics to track and analyze the collection section’s performance. It has limited reports with statistics about caseloads, collection methods used, and payments received, and as a result, the department does not know whether its collections approach is effective.

In order to assess the effectiveness of VDT’s collections approach, SAO requested that the department provide data extracts from ETM and Advantage Revenue. Based on the data in these extracts, SAO calculated the

¹² For purposes of this report, “closed case” means a case in ETM with a status of closed and “open case” means a case in ETM with a status other than closed (e.g., new case, investigate, etc.).

average length of time to close cases and the average age of open cases by status and summarized payments for delinquent PIT debt. However, further analysis to assess whether payments on delinquent PIT debt were the result of the actions of VDT compliance officers or OCAs and to assess the extent to which VDT used various collection methods and which were most effective was not possible. This is because 1) some data in the VDT extracts were not reliable, 2) VDT was unable to provide SAO with data in a form that would allow for assessing which of the department's collection methods are most effective at compelling payment of delinquent taxes, or 3) some data were not tracked in ETM or AR. For example, in the ETM extract the dates that cases were assigned to VDT compliance officers were not reliable and dates for referral to OCAs may have been for an unrelated case for the same taxpayer.¹³ Because these dates could not be used, there was no point of reference for attributing collection payments to VDT compliance officers or to OCAs. In addition, the use of some collection methods, such as wage garnishment, was not tracked in ETM, and payments from garnishment were not separately identified in AR.

VDT has implemented a new system, VTax, for many of its tax types, and PIT is scheduled to be transitioned to this system in December 2016. This new system has better reporting capabilities than ETM and appears to be configured to collect information that will support analysis of collection methods and the payments associated with each method. For example, a VTax report is available that shows collections by tax compliance officer with the type of payment and by collection stage (e.g., 1st collection notice, payment plan, etc.). Another report shows the age of cases when the payment came in and whether it was at OCA, payment plan, offset, or collector action.

About One-Third of Payments on Delinquent PIT Debt Occurred Prior to End of Self-Cure Period

About \$4.3 of the total \$12.9 million collected was on cases that closed during the time VDT describes as the self-cure period. The self-cure period, which ranges from 10 to 270 days, depending on value of the debt and collection risk,¹⁴ commences with the date of the first letter that includes notice of the delinquency to the taxpayer, and is generally before active

¹³ Referral to an OCA, including the date referral occurred, is tracked at an individual level in ETM. There could be multiple cases for different tax types associated with an individual. As a result, the referral dates in the ETM extract could be for an unrelated case.

¹⁴ VDT assesses collection risk for cases as low, medium or high.

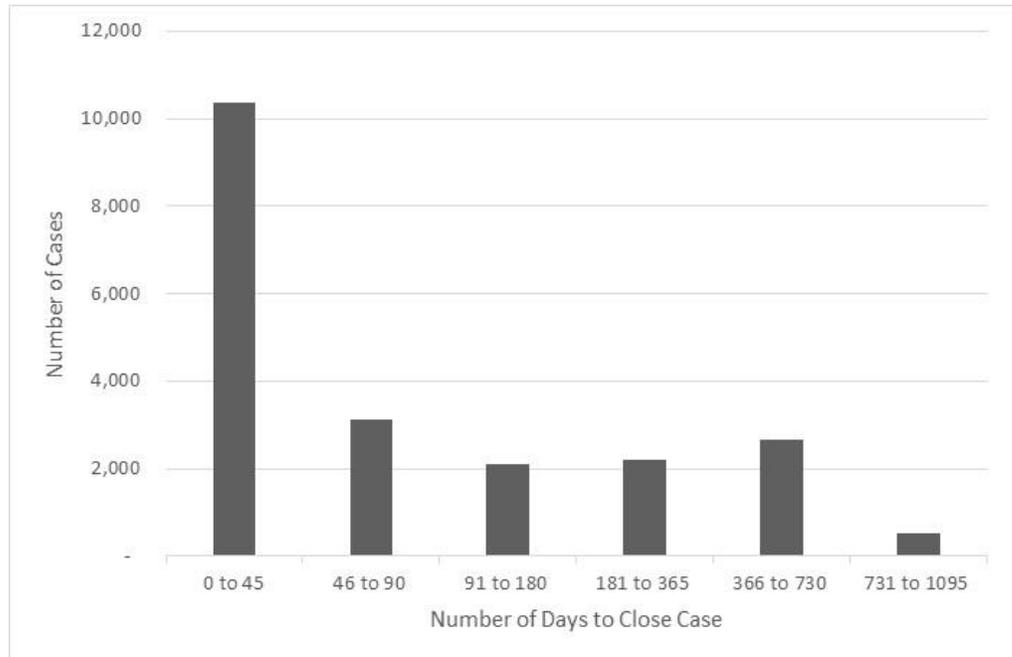
collection is pursued by a VDT compliance officer or an OCA. Based on VDT's data, it appears that the self-cure period is longer than needed for many cases. If the self-cure periods were shorter, active collection could commence sooner for those debts not paid prior to end of self-cure.

According to a report by the United States Treasury Inspector General (IG) for Tax Administration, the probability of settling unpaid accounts in the collection industry falls dramatically over time. Extended self-cure periods may reduce the likelihood of collecting delinquent PIT taxes that do not resolve during self-cure. VDT established the current self-cure periods in 2012, but since that time has not assessed whether the length of time established for self-cure is appropriate.

During the self-cure period, notices of amounts due are automatically generated by ETM and mailed to taxpayers. To the extent that taxpayers then take action to pay or otherwise resolve their balance due, collections can occur with relatively little additional VDT investment. Once the self-cure period has ended, active collections commence by VDT or cases are sent to OCAs.

SAO analysis of VDT data shows that 74 percent of cases (15,227 of 20,947 closed cases) are closed within 180 days and about 33 percent of payments (\$4.3 of \$12.9 million) on delinquent PIT debt occurred for cases that closed within the self-cure period. See Figure 1 for the timing of cases closing.

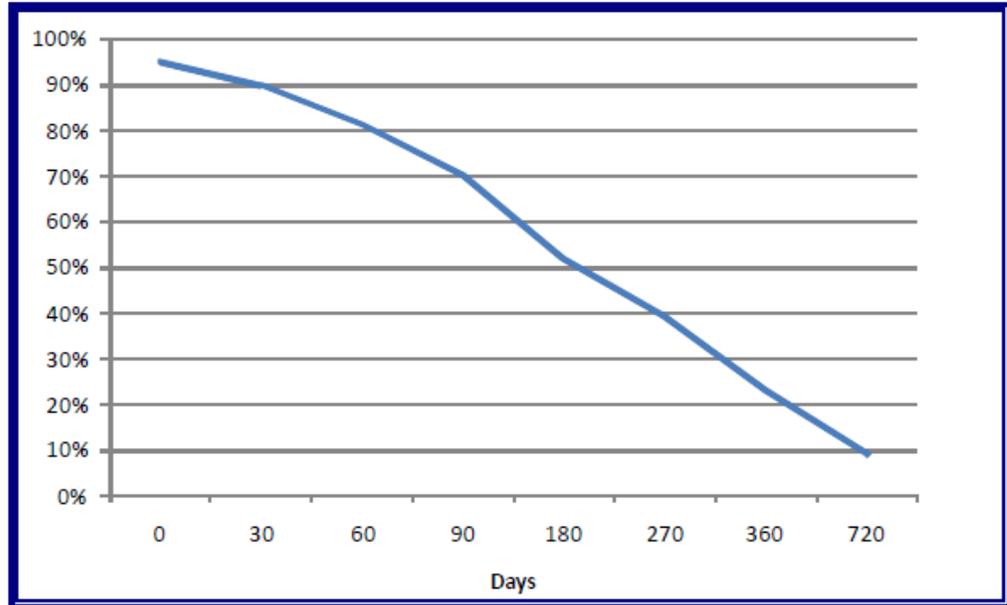
Figure 1: Number of Cases Closed Within Six Time Periods.



Shortening Self-Cure Periods May Improve Collections

It is generally acknowledged in the collection industry that more timely pursuit of liabilities is preferable. Further, the probability of collection decreases over time. See Figure 2 for the Generally Accepted Industry Collectability Curve, which shows the reduction of the probability of settling unpaid accounts over time.

Figure 2: Generally Accepted Industry Collectability Curve



Source: Commercial Collection Agency Association.

SAO analysis of closed cases shows that the majority of low dollar cases (less than \$500) and low/medium dollar cases (\$500 to \$2,500) resolve well before the end of the time allowed for self-cure.¹⁵ Specifically, the average number of days to close low dollar and low/medium dollar cases was 126 days and 142 days, respectively.¹⁶ The general treatment for low dollar cases with low and medium risk, low dollar cases with high risk, and low/medium dollar cases with low and medium risk is a self-cure period of 270 days, 180 days, and 180 days, respectively. Those cases that have not been fully paid or do not have a payment plan are sent to an OCA. VDT provides a 15-day notice before the cases are sent to OCAs, which means that active collection on these cases may not occur for 285 days, 195 days, and 195 days, respectively.

By the time the self-cure period and subsequent notice period have ended for low dollar and low/medium dollar cases, the likelihood of collection drops to about 35 percent and 45 percent, respectively, according to the Collectability Curve. Given that most of these cases are resolving within 126 days and 142

¹⁵ SAO excluded the 2,695 low/medium dollar, high risk cases that closed because the average number of days to close was 179 which is after the end of the 90-day self-cure period.

¹⁶ 13,498 out of 18,293 (74%) of the low dollar cases for all risk levels closed within 126 days, and 1008 out of 1,418 (71%) low/medium dollar cases with low and medium risk closed within 142 days.

days, respectively, to maximize the potential of collecting the remaining open cases (cumulative balances of \$501,000 and \$244,000 due at July 24, 2015),¹⁷ the self-cure period could be shortened so that active collection could begin sooner and the probability of settling the unpaid balance increased. If the self-cure and subsequent notice periods were shortened to a combined total of 120 days for low dollar cases and 140 days for low/medium dollar cases, the Collectability Curve suggests that the probability of collection could increase to about 60 percent and 55 percent, respectively.

Status of Many Open Cases Could Mean That Active Collection Efforts Have Not Occurred

According to VDT's collection approach, of the 4,246 cases¹⁸ that remained open at July 24, 2015, 3,853 of these should be sent to an OCA once the self-cure period ends, rather than worked in-house by VDT compliance officers. Based on the age for cases in various treatments, many have exceeded the self-cure period and should be at an OCA. However, based on SAO analysis of VDT data, only 1,355¹⁹ cases have been referred an OCA. Although the collection case management system is configured with work flow rules designed to move certain cases to OCA once the self-cure period ends, VDT indicated there are processing issues that result in some cases getting "stuck" in the ETM system and not advancing to the next phase according to the rules established in the system. It's likely that many of the low dollar or low/medium dollar cases that should be sent to OCA are not being pursued by VDT compliance officers since each officer is assigned, on average, 1,500 cases.²⁰ The total amount due for low dollar and low/medium dollar cases is \$2.4 million.

VDT has used a data warehouse since 2012 to determine a risk score for each delinquent PIT collection case. Based on the risk score and dollar value of the delinquent PIT debt, each case is classified according to an expected treatment scenario. Treatment scenarios vary by length of time for the self-cure period and whether collection will be pursued by VDT or OCA. The

¹⁷ The total balance due for low/medium dollar cases is \$1.9 million; \$244,000 represents the balance due on low/medium dollar cases with low and medium risk.

¹⁸ Total open cases as of July 24, 2015 equals 4,531. However, 285 have zero balance due and are not included.

¹⁹ In total, there are 1,361 cases at OCA, but six have no balance due.

²⁰ This figure is based on cases for the tax types managed using ETM. Cases for tax types that are not in ETM, corporate and business income, are not included in this figure.

intent of this process is to focus the appropriate resources for each case and increase the likelihood of collection.

See Table 2 for the number of open cases, average case age, and length of self-cure period by treatment scenario as of July 24, 2015.

Table 2: Number of Open Cases with Treatment Scenario and Average Age as of July 24, 2015 Compared to Self-Cure Period

Debt Amount	Treatment Scenario	Number of Cases	Average Case Age (Days)	Self-Cure Period (Days)	Collection Assignment
< \$500	Low dollar, low risk	213	148	270	Referral to OCA
	Low dollar, medium risk	612	432	270	
	Low dollar, high risk	1,202	469	180	
>=\$500 and <\$2,500	Low/medium dollar, low risk	81	186	180	
	Low/medium dollar, medium risk	134	359	180	
	Low/medium dollar, high risk	1,392	521	90	
>=\$2,500 and <\$5,000	Medium dollar, low risk	25	223	135	VDT
	Medium dollar, medium risk	37	371	90	
	Medium dollar, high risk	219	556	90	Referral to OCA
>=\$5,000 and <\$10,000	High dollar, low risk	6	229	90	VDT
	High dollar, medium risk	9	466	90	
	High dollar, high risk	128	526	10	
>=\$10,000	Very High Dollar	112	529	10	
	No Score	23	239	90	Supervisor Determines
	Data Not Available	53	432	Not available	Not available
	TOTAL	4,246^a			

^a Total open cases as of July 24, 2015 equals 4,531. However, 285 have zero balance due and are not included for purposes of this table.

Status of Open Cases

When taxpayers do not resolve the balance due during the self-cure period, the delinquent obligations are assigned to a status for resolution by a VDT compliance officer or an OCA. ETM is configured with case work flow rules to move cases through various statuses, including referral to an OCA. Table 3 shows the number of cases by dollar value, summary status, original delinquent balance, amount collected and amount due as of July 24, 2015.

Table 3: Statistics for Open Cases as of July 24, 2015, dollar amounts rounded

	DOLLAR VALUE						TOTALS
	Low	Low/ Medium	Medium	High/ Very High	No Score/ Blank	Zero Balance at 7/24/2015	
	Number of Cases						
OCA	475	639	99	121	21	6	1,361
New Case	380	93	11	6	8	33	531
Worked in-house	1,172	875	171	128	47	246	2,639
Total	2,027	1,607	281	255	76	285	4,531
Original Delinquent Balance	\$590,000	\$2,059,000	\$1,029,000	\$3,730,000	\$293,000	\$1,616,000	\$9,317,000
Total Collected	\$175,000	\$427,000	\$187,000	\$382,000	\$63,000	\$1,243,000	\$2,477,000 ^a
% Collected	30%	21%	18%	10%	21%	77%	27%
Due 7/24/15	\$501,000	\$1,942,000	\$ 957,000	\$3,497,000	\$272,000	\$ -	\$7,169,000

^a Approximately \$308,000 of the total collected is for new cases. Most of these cases are still within their self-cure period.

Many Collection Cases Should Be at OCAs, but VDT Collection Approach Not Always Followed

According to VDT’s collections approach, 92 percent of the open delinquent PIT cases should be sent to an outside collection agency 105 to 285 days subsequent to the initial notice of assessment provided to the taxpayer. However, less than a third have been referred (Table 3) even though the average age for most of the cases in the treatment scenarios highlighted in Table 2 far exceed the time at which cases should have been sent to OCA. As a result, many of the open cases are in a collection status that does not appear consistent with VDT’s described collection approach.

The following table shows more detail related to case status, number of cases and average age of cases by status as of July 24, 2015. (See Appendix III for a complete list of status codes and definitions.)

Table 4: Number of Open Cases, Average Case Age and Balance Due at July 24, 2015, dollar amounts rounded

Status	Number of Cases	Average Age	Remaining Balance Due 7/24/15
New Case	498	96	\$194,000
At OCA	1,355	570	\$3,003,000
Pending Assignment to OCA	1,148	476	\$1,054,000
Appeal, Bankruptcy, Hardship, Other	127	450	\$923,000
Worked In-House -Payment Plans	181	326	\$478,000
Worked In-House – Eligible for Lien	43	277	\$139,000
Worked In-House – Enforced Legal Action	60	597	\$648,000
Worked In-House – Case Assign	490	466	\$208,000
Worked In-House - Invalid Address	209	490	\$23,000
Worked In-House – Investigate, Awaiting Information, Other	135	474	\$499,000
TOTALS	4,246		\$7,169,000

Excluding the cases in “new case” status, 2,393 cases are in a status that indicate the cases remain at VDT for collection.²¹ About 15 percent (368) of these cases have a payment plan, are in appeal or bankruptcy, or VDT attorneys are pursuing a legal judgment. However, there are 616 and 532 cases in “OCA No Lien” and “OCA Notification” status (grouped as pending assignment to OCA in Table 4), and the average age for these cases is 476 days. According to VDT, cases destined for OCA referral proceed through these stages before referral to an OCA. However, given their average age, many of these cases should already have been referred to an OCA for collection. Similarly, 209 have a status of “invalid address” with an average

²¹ New cases are still in the self-cure period.

age of 490 days. Per VDT, cases lacking a valid address should be sent to OCA after 10 days of being placed in this status.

Almost 500 cases are in the status code “case assign,” with an average age of 466 days. VDT explained that this status code is for new cases. However, VDT’s requirements document for the configuration of case workflow rules within ETM indicate that new and reopened cases are in the case-assign status for 30 days and that in some instances cases are automatically moved to “case-assign” when an installment payment plan is broken. According to VDT, there may have been updates to the ETM system that were not documented in the requirements document. As a result, it’s not clear how the “case assign” status is supposed to be utilized, what it means when a case is in this status, and how long a case should be in this status. Furthermore, VDT lacks final documentation for the configuration of the case workflow within ETM.

Causes

According to VDT, the ETM case management system reassesses the status for all cases nightly, but there are processing issues that result in some cases getting “stuck” and not advancing to the next phase according to the rules established in the system. Also, ETM is configured to hold cases (i.e., not advance the case to the next status code) for 60 days if a payment is received and for 90 days if contact with a taxpayer is noted on the case. Further, VDT indicated that compliance officers may have manually pulled cases out of the automated process for a variety of reasons and subsequently failed to reevaluate/reset them back into the flow in a timely manner.

VDT’s August 2015 collection case report shows that the average number of delinquent tax cases (cases in ETM) assigned to a compliance officer is 1,500.²² Current expectations for the compliance officers indicate that their focus should be on the top 100 balances each month. Due to the large case load and the expectation that compliance officers focus on the top 100 cases assigned to them, many of the 2,047 low dollar and low/medium dollar cases that remain at VDT may not be subject to active collection efforts by compliance officers.

Other possible causes may be that VDT’s collection strategy is not sufficiently documented. VDT compliance officers receive on-the-job training, but without a documented collection strategy, including whether

²² During August 2015, there were 10 full-time compliance officers.

cases should be referred directly to OCAs and when it is acceptable for compliance officers to manually assign cases to themselves, VDT adds to the risk that cases won't proceed in a timely manner and according to the department's collections approach. According to a benchmarking study of government tax administrations,²³ the most effective tax administrations provide clear, centralized guidance to compliance officers, including step-by-step checklists and well-defined guidelines, which results in a more uniform and systematic approach to settling debts.

Offsets Yield Payments on Delinquent PIT Debt, but Extent of Use of Some Collection Methods and the Effect on Payment of Delinquent PIT Debt Not Known

VDT has various collection methods it may use to facilitate and enforce payment of delinquent PIT debt. The department may use offsets of state and federal tax refunds,²⁴ unclaimed property, and vendor payments²⁵ against delinquent PIT debts. Other allowed collection methods include installment payment plans, liens against real property,²⁶ wage garnishment, and bank levy among other tools. However, VDT has not established performance measures to assess the results of its collection operations and does not have reports that provide information needed to review the use of various collection methods and their effectiveness. The department has some reports used to review compliance officers' caseloads and periodically compares these reports to determine whether compliance officers have resolved cases. In addition, VDT has reports for the number of liens filed and released, number of phone calls by compliance officers, and number of referrals to VDT attorneys for legal action. However, these metrics do not provide sufficient information to assess the effectiveness of VDT's collection approach.

SAO analyzed the VDT data extracts and this yielded some information regarding the extent of the department's use of various collection methods and effect on payment of delinquent PIT debt. According to VDT payment

²³ McKinsey & Company, "The Road to Improved Compliance, A McKinsey benchmarking study of tax administrations 2008-2009."

²⁴ VDT participates in the United States Treasury Offset Program through which it receives federal income tax refunds to apply to state tax debts.

²⁵ The vendor payment offset program allows the department to conduct data matches with the Department of Finance & Management to identify payments the State owes to vendors who owe tax debts. The payments owed to vendors by the State are instead paid to VDT to offset tax debts.

²⁶ Liens are placed on the real estate of delinquent taxpayers to protect the State's security interest (e.g., collateral) in the tax debt and to establish priority against other creditors.

data, approximately \$2.4 million of delinquent PIT debt was collected using various offsets subsequent to the taxpayer being notified of the delinquency. See Table 5 for a list of payments received by type of offset.

Table 5: Payments for Delinquent PIT Debt by Offset Type, Applied from January 1, 2013 to July 24, 2015, dollar amounts rounded

Offset Type	Offset Description	Amount Applied to PIT Debt
Internal Offset	A state tax refund owed to a taxpayer may be treated as a payment by the taxpayer and applied to a taxpayer's liability for any period.	\$1,553,000
U.S. Treasury Offset Program	Federal tax refund offset against delinquent tax debt.	\$452,000
Credit Carryforward	Overpayments on state tax returns applied against delinquent tax debt.	\$331,000
Unclaimed Property	Abandoned property offset against delinquent tax debt.	\$50,000
Vendor	Payments owed to vendors by state agencies, departments, boards, commissions, authorities or public corporations offset against delinquent tax debt.	\$41,000
TOTAL		\$2,427,000

However, based on the data provided by VDT, it's not possible to determine whether the additional \$10.5 million of payments were the result of the actions of VDT compliance officers, outside collection agencies or taxpayer corrective action in response to a letter or notice. Nor is it possible to determine the extent to which the department utilized its various collection methods or which collection methods were most effective. These limitations are due in part to a lack of fields for some data and the structure of the relationship between accounts and cases in ETM.²⁷ It is also because the payment information system in AR is not configured to capture details that would support these kinds of analyses. For example, payments made by

²⁷ ETM links cases to individuals and each individual taxpayer may be linked to multiple cases (for example one case as single, one case as married). Some of the data elements within ETM are at the individual level and other data is at the case level. For example, date of OCA referral and installment payment plan are at the taxpayer level, not the case level.

taxpayers directly to VDT for cases that are managed by an OCA are not categorized within AR as OCA payments.

The collection case data provided by VDT included whether liens²⁸ were filed and the number of cases with installment payment plans, but did not provide information about other collection methods such as wage garnishment and suspension or revocation of professional licenses.

- **Liens:** Per the data extract, 666 liens were filed on cases that were open as of July 24, 2015.
- **Installment payment plans:** 181 open cases had installment payment plans in place at July 24, 2015.
- **Wage garnishment:** VDT conducted a special project to pursue wage garnishment in 2013 and the results were tracked in an Access® database. The database did not indicate whether a wage garnishment was applied to a case, just that the case had been referred to VDT attorneys. Effective July 1, 2015, VDT may pursue wage garnishment via an administrative process without obtaining a legal judgment. Commencing in January 2016, VDT implemented a process to track wage garnishment and reported to SAO that as of the mid-February 2016, there were 31 cases subject to wage garnishment. There are no fields in ETM to track wage garnishment.
- **Suspension or revocation of professional license:** According to VDT, data have not been collected about the number of letters sent to notify taxpayers that their professional licenses have been referred to the appropriate state entity for consideration of suspension or revocation. Based on the status codes provided by VDT, there is no field in ETM to track this data. A tax compliance manager estimated that 20 to 30 letters are sent to debtors each year that hold professional licenses and that perhaps two may have hearings held to determine whether to suspend or revoke licenses. In 2015, VDT adjusted its second billing notice to inform taxpayers that professional licenses could be suspended or revoked for non-payment of PIT. However, data regarding the use of this collection method remain unavailable.

²⁸ Liens are filed on real estate and generally for cases with balances greater than \$1,000.

Other collection methods, such as offsets to lottery winnings and bank levy, are available to VDT but have not been used. With regard to lottery offsets, the department explained that there was an effort to coordinate this offset with the Vermont Lottery, but technology challenges and other differences between VDT and the Lottery were not resolved. With the transition of PIT to VTax scheduled for December 2016, this may be a good time to revisit lottery offsets.

Effective July 1, 2015, bank levy may be conducted via an administrative process. VDT has drafted procedures for using bank levies²⁹ and in January 2016 signed a contract with a service provider who will identify which taxpayers with delinquent debt have bank accounts that may be levied.

Not Possible To Discern Which Collection Methods Result in Payment of Delinquent PIT Cases

VDT has information in AR about the payments related to various offsets and there is some information in ETM about collection methods used. However, many of the payment categories in AR do not provide information about the type of collection method that was used to prompt payment. For example, one payment category in AR is “amended return,” which indicates that payment was received in connection with an amended return, but this provides no information about the collection method that was used to prompt payment. In addition, the category in AR related to OCA payments is understated. VDT receives reports and a detail file from OCAs of payments, and the detail payment file is utilized to update cash receipts in Advantage Revenue. However, VDT acknowledged that the payments made by taxpayers directly to VDT for cases that are managed by an OCA are not categorized within AR as OCA payment although the department considers these to be OCA payments.

Some of the data in the VDT extract is not tracked at a case level and may not be used to analyze collection actions for the cases. For example, dates for referral to OCA and implementation of an installment payment plan do not

²⁹ Subsequent to the issuance of the draft report for management comment, VDT provided SAO with a final version of the bank levy procedures effective April 11, 2016.

necessarily relate to the case in the extract because these dates are from ETM system tables that relate to an individual, not a case.³⁰

ETM data indicated when cases closed and Advantage Revenue contained payment data that could be used to calculate the amount of payments received for closed cases, but ETM data did not show whether a case was at an OCA or being worked in-house by VDT compliance officers and the collection method used when the case closed. As a result, the data may be used to summarize payments for closed cases, but does not provide information regarding the collection method used to elicit payment. Further, the data VDT provided to SAO indicates the status of cases at July 24, 2015, but payments may have been received when these cases were in a different status. As a result, it's not possible to determine whether the payments received are associated with the current status listed in Table 4 or a previous status. For example, payments for cases listed in the status "Worked in-house – Payment Plans" could have occurred prior to a payment plan being entered into, such as from refund offsets or carryforward amounts.

Lack of Performance Measures for Collection Section

VDT's philosophy is to collect the proper amount of tax revenue in a timely and efficient manner. Some general expectations have been provided to compliance officers with regard to which cases have priority and a suggested sequence for managing collections. However, VDT has not established performance measures for its collection operations or its tax compliance officers. Further, the reports used by the department focus on managing caseload and compiling the volume of activities of tax compliance officers, such as number of phone calls and liens released, but other statistical reports are needed to assess whether the department is collecting the proper amount of tax in a timely and efficient manner. The department has developed a list of performance metrics for the OCAs and indicated that the reporting capability to track actual results is in development. The Internal Revenue Service and other states use measures such as age of case inventory, percent of delinquent taxes collected in-house, and dollars collected through all collection methods. Appendix V includes a list of performance measures used by the Internal Revenue Service and other state tax departments.

³⁰ Within ETM, each individual has a "person id." There may be multiple cases associated with each person id. Since the dates for referral to OCA and start of an IPA are tracked in ETM at the person id level, these dates may be related to cases that are not included in the data extract.

VDT has not assessed its collection approach and does not know which of its collection methods, such as payment plans or liens, are most effective at prompting payment on delinquent PIT debt. A reason for this may be issues the department experienced with transitioning to ETM in 2010 and the decision in 2012 to transition to another IT system.

Regardless, according to the Treasury Inspector General for Tax Administration, having measures that provide ongoing performance information to management and stakeholders is critical to sound decision making. Such information assists in making decisions about how to fund and allocate resources to collect taxes from taxpayers who owe but have not paid.

Conclusions

VDT collected more than half of the original balance due for PIT debt identified as delinquent during 2013 and 2014. However, the department did not have the statistical reporting needed to assess the effectiveness of its collections approach, in part because its systems were not designed to capture data for all collection methods or all sources of payments.

Using VDT-provided data extracts from ETM and AR, SAO calculated some statistics, such as average days to close cases, payments for cases that closed during the self-cure period, and average age of open cases by status (e.g., at OCA, new, and payment plans). The results of the SAO analysis indicate that the self-cure period is longer than needed for many cases. Decreasing the self-cure period could accelerate the time for active collection, which could increase the probability of collecting on cases that remain open subsequent to the self-cure period. Further, the age and status of many open cases suggest that VDT's collection approach was not always followed since many low dollar and low/medium dollar cases remained at VDT rather than being sent to OCAs per established treatment scenarios. The average caseload for collectors, combined with the large number of low dollar and low/medium dollar cases in "OCA-no lien" and "OCA-notification," indicate that it's possible that active collection efforts have not occurred for these cases.

Further analysis to assess whether payments on delinquent PIT debt were the result of the actions of VDT compliance officers or OCAs and to assess the extent to which VDT used various collection methods and which were most effective was not possible because of data limitations. Once PIT is transitioned to VTax in December 2016, VDT will have improved reporting capabilities. VTax appears to be configured to summarize data to show

whether collections occurred under a VDT compliance officer or while at an OCA, the type of collection method (e.g., payment plan, offset, etc.) that was in use when payments were received, and the age of various case statuses. When these data are available they can be used by VDT to assess collection methods, compliance officers, and OCAs and to determine whether cases are being worked according to VDT's preferred collections approach.

Recommendations

We make the following recommendations to the Commissioner of the Department of Taxes:

Table 6: Recommendations and Related Issues

Recommendation	Report Page	Issue
1. Decrease the self-cure period for low dollar cases of all risk levels and low/medium dollar cases of low and medium risk to 120 and 140 days, respectively.	14-15	By the time the self-cure period and subsequent notice period have ended for low dollar and low/medium dollar cases, the likelihood of collection has dropped to about 30 percent and 45 percent, respectively. However, the average number of days to close low dollar and low/medium dollar cases was 126 days and 142 days, respectively, and most cases of these dollar amounts close before the average. According to the Collectability Curve, if the self-cure and subsequent notice periods were shortened to a combined total of 120 days for low dollar cases and 140 days for low/medium dollar cases, the probability of collection could increase to 60 percent and 55 percent, respectively.
2. Until PIT is transitioned to VTax, utilize case data in ETM to periodically identify cases in status codes OCA-no lien, OCA notification, and invalid address	20-21	About 1,100 cases with an average age of 476 days are pending referral to OCA and more than 200 are identified as having "invalid-address" with an average age of 490 days as of July 24,

Recommendation	Report Page	Issue
with ages that exceed the self-cure period parameters and determine whether these accounts should be referred to OCAs.		2015. Many of these cases should have already been sent to an OCA according to VDT's treatment scenarios and collection approach.
3. Once PIT is transitioned to VTax, utilize the VTax query that shows cases by collector, status code and aging buckets to identify cases that have not followed VDT's collection approach and develop a process to follow-up and address those cases that are not in compliance.	20-21	See above issue.
4. Ensure the case workflow configuration for VTax is documented and contains adequate information, including definitions for all case statuses, the number of days a case remains in a particular status, and/or whether the case requires a manual adjustment to another status.	21-22	About 500 cases are in "case-assign" status with an average age of 466 days. It's difficult to discern whether this is an appropriate status for these cases, because there are differences between VDT's explanation for the status and a requirements document for the ETM case workflow that was never finalized. Further, it's not clear if these cases automatically move to another status based on parameters established in ETM or if they require manual adjustment to another status.
5. Document the VDT collection strategy, including whether cases should be referred directly to an OCA, when it is appropriate for tax compliance officers to manually assign cases, and the preferred hierarchy of the use of VDT's collection methods.	21-22	VDT lacks sufficient documentation of the collection strategy and risks that collection on cases won't progress in a timely manner and according to the department's preferred collection approach.
6. Ensure that VTax is configured to track all collection methods utilized by VDT, including wage garnishment, bank levy, and	24-25	Currently, VDT tracks the date that liens are filed and has a status code for cases subject to installment payment plans within ETM. However, the

Recommendation	Report Page	Issue
suspension or revocation of professional licenses.		department is tracking wage garnishment in an Access® database and does not track the use of suspension/ revocation of professional licenses.
7. Collaborate with the Vermont Lottery to revisit the possibility of implementing a process to facilitate offsets of delinquent PIT debt with lottery winnings.	25	Delinquent tax debt may be offset with lottery winnings, but technology challenges and other differences between VDT and the Lottery have not been resolved.
8. Develop and track performance metrics for collection operations and tax compliance officers.	26-27	VDT has not established performance measures for its collection operations or its tax compliance officers.

Management's Comments and Our Evaluation

On April 11, 2016, the Commissioner of the Department of Taxes provided comments on a draft of this report. These comments are reprinted in Appendix VI along with our evaluation of the comments. The Commissioner agreed with our finding and in most cases, the comments included statements that improvements would be made or were in process.

In accordance with 32 VSA §163, we are also providing copies of this report to the commissioner of the Department of Finance and Management and the Department of Libraries. In addition, the report will be made available at no charge on the state auditor's website, <http://auditor.vermont.gov/>.

Appendix I

Scope and Methodology

To address our audit objective, we obtained an understanding of VDT's collection approach, by reviewing process flow charts and standard operating procedures, including those related to filing liens and sending notices to taxpayers and the appeal process. We also interviewed VDT personnel to gain an overview of the systems and the procedures used in collecting PIT debt and to understand the details of the collection process, including timing of commencement of collections, assessing collection risk and assigning treatment scenarios, and collection methods (e.g., liens, wage garnishment). We reviewed an ETM requirements document that showed the progression of the case work flow within ETM. We reviewed Vermont state statutes regarding personal income tax and the administration of collections.

To understand how VDT monitors its collections and whether VDT establishes goals and performance measures for collections, we reviewed documentation, such as VDT's fiscal year 2016 annual budget, 2015-2018 draft strategic plan, and an August 2015 document that established some expectations for compliance officers. For further insight into VDT performance, we reviewed various VDT reports to the Legislature on compliance section activities and results. We inquired of senior staff about monitoring, goals, and performance measures for collections.

To gain insight regarding Internal Revenue Service (IRS) and other states collection methods and performance measures, we reviewed Government Accountability Office (GAO), Treasury Inspector General for Tax Administration, and other states' audit reports on collections. We researched and compiled information about IRS and other states' collection methods, performance measures used to assess effectiveness of collections, and performance goals for collectors.

For information on the outside collection agencies, we reviewed the contracts for the two companies hired by VDT and a report dated August 2015 on the results of their collection efforts, summarized for all tax types, over one month in 2015.

We identified collection methods that VDT is statutorily authorized to use, but did not employ, and obtained explanations for why the methods were not used or confirmed that the use was not tracked by VDT.

We reviewed documentation about the design of the new VTax system, and heard a presentation and received information from VTax staff on the reporting capabilities of the VTax system. We reviewed the project charter and the contract with the company implementing the system. We also looked at VDT reports indicating the progress of the project.

Appendix I

Scope and Methodology

We utilized Microsoft Excel® to analyze collections practices based on extracts from ETM and AR and our understanding of treatment scenarios and methods used to collect delinquent PIT. We compared the results of our analysis to VDT's internally established practices and inquired of management regarding the cause of inconsistencies/anomalies.

To perform our analyses, we received a data extract from the ETM system which contained 30,433 cases initiated in 2013 and 2014 within which were 37,483 obligations. The wage garnishment data provided with this extract was pulled from an Access® database used by VDT for a special project. We also received extracts from AR for the data elements contained in the initial letter sent to notify taxpayers of delinquent PIT debt and for payments for the obligations included in the ETM data extract. We tested this data to determine whether it was sufficiently reliable for purposes of our audit objective.

In designing our approach to assess whether the data extracts were sufficiently reliable, we considered the GAO Data Reliability Guide, which outlines a variety of approaches for data reliability assessment. These include performing data testing and tracing to and from source documentation. Data testing relates to applying logical tests to electronic data files, such as looking for duplicate records or values outside of a designated range. With respect to tracing to and from source documents, the GAO guide refers to tracing a random sample of data records to help determine whether the computer data accurately and completely reflect these documents.

Consistent with this guidance, we gained an understanding of the data elements in the extracts and the interrelationships among the data elements and values through: 1) interviews of VDT collections section personnel, data analysts and information technology personnel, specifically obtaining definitions for the data elements, including case status, treatment scenarios, and payment types, 2) review of requirements documents for case work flow within ETM, and 3) inquiries of VDT personnel about whether they had knowledge of any issues with reliability of their data.

Further, we:

- 1) reviewed the queries VDT utilized to extract data from ETM and confirmed our understanding of the query parameters with VDT data analysts,
- 2) scanned the extracts for obvious errors (e.g., alpha characters in date or numerical fields, unexpected blanks in fields and garbled data),
- 3) tested relationships among the data elements (e.g. compared various dates based on expected relationships such as that case create date

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- should be subsequent to the date the initial letter with notification of delinquency was sent to the taxpayer), and
- 4) corroborated the current obligation balance per case in the ETM extract to the amounts in the June 30, 2015 accounts receivable file from AR.

Based on the results of these preliminary procedures, we determined that some of the data in the ETM extracts were not reliable or did not reflect expected relationships among data elements. Specifically, we noted the following:

- IPA and OCA dates were not useable because this data is stored at the Person ID level, not the case level and case level was needed for purposes of our analysis.
- Initial letter dates did not consistently precede the case create date.
- Amounts in the offset field did not include all offsets types, only Vermont state income tax refund offsets so excluded offsets such as federal income tax refunds and unclaimed property.

As an alternative to working solely with the data extract from ETM, we requested extracts from AR for 1) key data associated with the initial letter sent to taxpayers such as original balance due and 2) payment data.

We performed similar preliminary procedures for these extracts, scanning them for obvious errors and testing relationships among the data points.

Based on the results of these preliminary procedures, we noted the following:

- In several cases the letter sent date in the AR extract was much earlier or much later than the case create date from the ETM extract, which was unexpected. Specifically, there were 4.8% of cases (1,449) where the difference between dates appeared excessive.
- 712 obligations had no values in the initial letter extract because there was no first bill sent to the taxpayer and we concluded these data were not reliable.
- Amounts in the payment field were for all payments associated with a case, including those payments that preceded the date the delinquency was identified.

We performed additional procedures to test the accuracy of the data in the three extracts.

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Scope and Methodology

We selected a judgmental sample of 30 cases from the ETM data extract. We compared data elements from the extract for these 30 cases to source information in the ETM and Advantage Revenue systems. Testing showed that the fields for consolidated bill state 1 & 2, assigned to collector date, and wage garnish letter date could not be relied upon. We found that current risk score, current score date, current score model appeared to be unreliable. However, it was determined that the reason for this was that the data was a mix of original (e.g., from first instance that case was assessed for risk and assigned a treatment value) and current data (most recent risk score), not current as the data extract field indicated. After VDT provided an update of the data for current risk score, current score date, current score model and original risk score, original score date, and current score model, we retested these elements and concluded that they were sufficient reliable.

We selected a judgmental sample of 30 obligations from the AR payment extract. These obligations were compared with the ETM data extract to determine if the obligations were in both extracts; no exceptions were found. Each payment, with related details, was reviewed in the AR system and all data points were found to match between the extract and AR screens with payment detail (e.g. payments and offsets screens.)

As a result of the unexpected relationship between the initial letter sent date and the case create date for 1,449 cases in the AR initial letter file, SAO determined to segregate the extract into two populations for testing to source documents. A statistical sample of the 1,449 cases with date discrepancies was selected using IDEA® (computer assisted auditing software). Testing of these 1,449 cases revealed numerous varying reasons for the discrepancies in dates. Additionally, even in cases where there was a good reason for the date difference, the difference affected the attribution of payments and offsets to collections. We concluded that a statistical sample could not be projected to the population because of the varying reasons for discrepancies and that it was not practical to research each case individually. As a result, we concluded that the letter sent date information for this subset of the population is of undetermined reliability. For the remainder of the population (28,502 cases with letter sent dates close to the case create date), a statistical sample was selected and no discrepancies were found. We concluded that the initial letter sent date for these cases were sufficiently reliable for purposes of our audit objective.

Utilizing our automated data analysis tool, IDEA®, and Microsoft Excel®, we performed a variety of analyses with the data that we determined were sufficiently reliable from the ETM extract and AR data extracts. Since the AR payment extract included all payments, to identify collections for

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Scope and Methodology

delinquent PIT cases, SAO summarized payments received subsequent to the date of the initial letter (date the taxpayer was notified of the tax delinquency). The following are among the sorts of analyses that we performed:

- Number of cases for which VDT employed collection methods such as filing liens and implementing payment plans.
- Cumulative dollar value of offsets.
- Average number of days to close a case.
- Dollars collected for closed cases.
- Average age of open cases by various status codes.
- Dollars collected for open cases, by low, low/medium, medium, and high dollar value.

We compared the results of our data analysis to the department's internally established procedures and inquired of senior staff explanations for differences. For example, we requested explanation for cases aged past the self-cure period that should be sent to OCA, but remained at VDT for collection.

Our audit field work was performed between May 2015 and March 2016, and included visits to the Department of Taxes headquarters in Montpelier, Vermont.

We conducted this performance audit in accordance with generally accepted government auditing standards, which require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II

Abbreviations

AR	Advantage Revenue
ETM	Enterprise Tax Management Processing and Collection system
GAO	Government Accountability Office
IG	Inspector General
IPA	Installment Payment Agreement
IRS	Internal Revenue Service
OCA	Outside Collection Agency
PIT	Personal Income Tax
RSI	Revenue Solutions Inc.
TIGTA	Treasury Inspector General for Tax Administration
TCO	Tax Compliance Officer
VDT	Vermont Department of Taxes
V.S.A.	Vermont Statutes Annotated
VTax	Vermont's new Integrated Tax System

Appendix III

Descriptions for ETM Status Codes

The following table contains a list of the ETM case status codes and descriptions.

Table 7: ETM Case Status Codes and Descriptions

CASE STATUS CODE	DESCRIPTION
Case – Assign	Status given when a case has just opened and is assigned to a Tax Compliance Officer for collection action.
Closed	The taxpayer has paid in full all tax debt associated to the case.
Deceased	A death certificate is received and there is no estate to collect from.
Elig – Lien	The system has identified the tax debt is available to have a lien filed on unpaid debt.
Enforced 2	Case has been referred to Tax Attorney General for court action – Petition to File.
Enforced 4	Case has been referred to Tax Attorney General for court action – Lawsuit.
Enforced 5	Case has been referred to Tax Attorney General for court action – Judgment Obtained.
Hardship	A taxpayer has submitted either or both a Financial and Income Statement and written letter requesting Hardship.
Hardship 2	As with Hardship above, and there was new debt added to the case.
Hold	Status places hold on system action for 30 days.
Incarcerate	Taxpayer has been identified to be incarcerated.
Incarcerate 2	As Incarcerate above, and new debt was added to the case.
Invalid-Addr	Mail is being returned by the U.S. Post Office stamped with no forwarding address.
Investigate 1	TCO is actively working the case.
Investigate 2	As Investigate 1 above and there was new debt added to the case.
IPA – High Dollar	The taxpayer entered into a repayment plan and recently breached the plan.
IPA – Monitor	The taxpayer entered into a repayment plan is meeting terms of agreement.
IPA – New Debt	The taxpayer entered into a repayment plan, is meeting the terms of the agreement, however hasn't paid current debt filed.
ManualMove	An in-between state, signifying the tax compliance officer has not moved the case to a subsequent status.
New – Case	A case has just moved into the collections database and hasn't been assigned to a TCO.
OCA- In-Betw	The case has been with the 1 st Stage OCA for two years and is being held at VDT. To be forwarded after 6 months to 2 nd Stage OCA.
OCA – No – Lien	The debt is going to be forwarded to an OCA, but needs to have a lien filed prior to referral.

Appendix III

Descriptions for ETM Status Codes

OCA – Notifica	The taxpayer has been sent a letter informing them that the case will be referred to an OCA within 15 days.
OCA – Stage 1	Case is with an OCA.
OCA – Stage 2	Case is out for a second time at an OCA.
OCA – Uncollec	Debt has been returned from both OCAs and returned uncollectible.
Pend-Cls-Leg	Debt which had a lien filed has been paid and the lien release needs to be sent to the Town Clerk or taxpayer has appealed of filed for bankruptcy.
Uncollect 1	Case converted from a legacy system as uncollectible status.
Wait – Call	Status places hold on system action for 7 days.
Wait – Info	Status places hold on system action for 30 days.

Appendix IV

Reasons Delinquent PIT Cases Close Without Payment

VDT provided a data extract that included 30,433 cases. Included in this population were 4,955 cases with a total balance due of \$12.4 million that had been identified by VDT as delinquent, but these cases closed without payment. Cases close without payment for a variety of reasons. See below for examples.

- A taxpayer makes estimated payments during a tax period as a single taxpayer, but files a joint return because status changed during the tax period. A case is opened because a return was not filed for the taxpayer under their single status. Once this is brought to the attention of the collections section, the estimated payments for the single taxpayer are moved to the joint return. The single case is closed.
- A delinquent tax assessment is generated based on information from the IRS and the IRS data was incorrect.
- Taxpayer files an amended return.
- Taxpayer files an incorrect IN-113 form, used to determine the allocation of Vermont income for nonresident or part-year resident and to exempt income for Vermont residents, with the tax return. When corrected information is received by VDT, no money is due.
- Taxpayer fails to file an IN-113 form. When the missing form is received by VDT, no money is due.

Appendix V

Performance Measures for Delinquent Tax Collections

Table 8: Performance Measures for Delinquent Tax Collections

Measure Category	Specific Measure	Source
Cycle Time	Review time spent per amount collected	State ^a
	Cases not sent timely to OCA	State
	Percent of cases closed within X months, time to close cases	Professional organization, ^b TIGTA ^c
Collection Methods	Number of payment plans approved but broken	Professional organization, State
	Volume of activity (liens, levies, garnishes)	TIGTA
	Percent of delinquent taxes collected by Outside Collection Agency	Professional organization
Efficiency of Staffing	Percent of phone calls answered	State
	Percent direct collection time	TIGTA
	Percent of delinquent taxes collected in-house	Professional organization
	Dollars collected for accounts assigned to collectors	TIGTA
	Number of cases closed compared to number of staff working cases	IRS ^d
	Number of case closures as a result of answering incoming taxpayer calls	TIGTA
	Taxpayer correspondence responded to within 30 days	State
	Dollars collected from offsets	State
	Case load per collector	State
Inventory	Age of case inventory by status code	TIGTA, State
	Average age of collections cases	Professional organization
	Number of delinquent accounts	State

Appendix V

Performance Measures for Delinquent Tax Collections

	Percent of open cases that were closed	IRS, State
Taxpayer Satisfaction	Satisfaction rate for taxpayers	IRS, professional organization
Dollars Collected	Average payment as a percent of balance owed	Professional Organization
	Dollars collected for accounts assigned to collectors	TIGTA, State
	Dollars collected resulting from answering incoming calls	TIGTA
	Dollars collected from refunds denied/other offsets	State
	Dollars collected through all tools	Professional organization, State
	Average dollars collected per Full Time Employee	Professional organization, State
	Dollars collected from installment agreements	TIGTA

^a The measure was found in an audit report from another state.

^b The measure was found in a report from an organization specializing in finance or collections.

^c The measure was found in a report from the U.S. Treasury Inspector General for Tax Administration (TIGTA).

^d The measure was found in either an internal or external report on the Internal Revenue Service.

Appendix VI

Comments from the Commissioner of the Department of Taxes and Our Evaluation



State of Vermont
Department of Taxes
133 State Street
Montpelier, VT 05633-1401

Agency of Administration

April 11, 2016

Douglas Hoffer
Vermont State Auditor
Office of the State Auditor

Dear Mr. Hoffer,

Thank you for your thorough review of the Vermont Department of Taxes (VDT) collection efforts related to Personal Income Tax (PIT). Please find management comments below related to the finding and recommendations.

An overall observation is that VDT is in the third year of a four-year project to implement an integrated tax system, VTax, that will enable us to retire multiple legacy systems that have limited our ability to provide optimum service to Vermont taxpayers. VTax, based on a commercially off the shelf solution that has been successfully utilized by numerous other revenue agencies, will allow the VDT to thoroughly modernize its operations and adopt best practices across its functions. Just halfway through this project, we already have demonstrated significant process improvements.

It is important to view this report as a snapshot from the rear view mirror as VDT quickly moves ahead with modernization. In fact, the current state of personal income tax collections illustrates why the VTax project is imperative for VDT. In 2007, VDT awarded a contract to CGI to implement the first phase of a project called ETM that was to utilize a new Oracle tax product for corporate and business income taxes, and all collections. To put it mildly, after a bumpy launch in 2010, ETM never functioned optimally and caused multiple issues for VDT, including with collections and in the interface with our personal income tax legacy system, Advantage Revenue.

VDT made the decision to halt the ETM project, and after a thorough RFP process, signed the VTax contract in early 2014. VDT has moved quickly to implement VTax, and the strides we have made just two years later is a testament to both our dedicated staff and our vendor partner. We already have implemented VTax for corporate and business income taxes, as well as nine other taxes, including sales and use tax. By the end of this year, we will have implemented VTax for collections and personal income tax, and will be able to retire both our ETM and Advantage Revenue legacy systems, a huge accomplishment.



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Agency of Administration

It must be noted that in the interim, even working within old systems with limited capabilities, VDT was able to improve collections by implementing a stand-alone data warehouse solution. However, when Phase 3 of VTax goes live later this year, we will have the capability to fully adopt all of the business process improvements that our Compliance Division has been developing in the area of collection.

Viewed in that context, the data limitations that made this audit a challenge simply highlight the constraints that our legacy systems have had on VDT operations. Your report confirms that our collection work can and will be improved greatly with the rapid transition to VTax continues. With that general observation, we list our specific responses below.

Management Response

Objective 1 Finding: VDT has reviewed the finding of the audit and agrees with the finding. VDT is aware that the current ETM system has limitations surrounding reporting, collection metrics, and case flow for PIT.

Response to the specific recommendations follows:

1. VDT agrees with and is currently looking at reducing the self-cure period in addition to a complete redesign of its current collection flow and procedures to be included with the new system (VTax) Phase 3 implementation slated for December 2016.
2. VDT recognizes it has cases within ETM that should have gone to an Outside Collection Agency (OCA) and subsequently have not. However, we currently lack the available resources that would be necessary to manually restage these cases or fix the underlying ETM. Therefore, we plan to resolve this issue with the redesign of the collection flow that will be implemented in VTax in December 2016.
3. VTax has the reporting functionality, queries, and a work items system in place to alert staff and supervisors if cases are not in compliance with the collection flow. Evidence of this functionality can be seen in the work items queue in production in the Taxpayer Services Division.
4. Compliance is currently reviewing and has begun the process to redesign the collection workflow. Part of the collection redesign will include clear definitions of case status, the number of days in the specific status and document if manual intervention is required and at what point.

See our
comment 1p. 45

See our
comment 2 p. 45



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5. VDT is in the process of documenting and creating procedures for the collection life cycle to include expedited OCA referral, Tax Compliance Officer (TCO) assignments, and the hierarchy of available collection methods.
6. Outcomes connected to collection methods will be tracked within VTax with the Phase 3 implementation.
7. As part of VTax Phase 3 launch, VDT will enhance its current web applications, which we believe will address the issues that have prevented VDT from offsetting Vermont Lottery winnings. Once the web applications are enhanced, VDT will contact Vermont Lottery to revisit the possibility of implementing a process to facilitate offset of delinquent PIT debt with lottery winnings.
8. VDT has finalized its bank levy procedure.
9. VDT has defined OCA metrics and has already requested the reporting to be developed. Once implemented, either before or concurrent with Phase 3 launch, VDT will have the means to evaluate and monitor OCA collection effectiveness. Benchmarking will be implemented in the upcoming months for Phase 2 and will continue to roll out in Phase 3. Benchmarking and new reporting will allow performance tracking of the Tax Compliance Officers. Reporting for collection operations exist within VTax and the roll out of formalized procedures will allow VDT to capture the necessary data points as TCO's will be trained to enter in the data in a manner to reflect the performance.

See our
comment 3 p. 45

See our
comment 4 p. 45

Thank you for the opportunity to comment on your findings.

Sincerely,

A handwritten signature in black ink that reads "Mary Peterson".

Mary Peterson
Commissioner
Vermont Department of Taxes
133 State Street
Montpelier, VT 05633-1401



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Comments from the Commissioner of the Department of Taxes and Our Evaluation

VDT addressed most of our recommendations, indicating whether the recommendation would be implemented and in some cases that changes were in process. The following presents our evaluation of specific comments made by the Commissioner.

Comment 1	SAO acknowledges VDT's concern regarding resource constraints. However, it's likely that many of the cases that should have been sent to an OCA are not being pursued by VDT compliance officers since each of the officers is assigned, on average, approximately 1,500. Approximately \$1.1 million is owed for cases that were pending referral to an OCA at July 24, 2015. Delays in referring these cases to an OCA could result in lower amounts collected since the probability of collection decreases over time.
Comment 2	The Commissioner reiterated what SAO reported; that VTax has reporting functionality and queries to highlight those cases that have not followed VDT's collection approach. However, she did not indicate whether the department would develop a process to follow-up and address those cases that are not in compliance.
Comment 3	VDT provided SAO with a copy of the finalized bank levy procedures subsequent to the issuance of the draft report for management comment. The effective date of these procedures is April 11, 2016. SAO added a footnote to the report on page 25.
Comment 4	In the draft report, SAO reported that OCA performance metrics were in development by VDT. In her comments, the Commissioner indicated that VDT had defined OCA metrics, but the department needed to develop reporting in order to evaluate and monitor OCA collection effectiveness. The final report has been updated to reflect this status.