



# **PERFORMANCE AUDIT REPORT**

## **Department of Revenue's Delinquent Tax Collection Process**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
February 1989**

# **Legislative Post Audit Committee**

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## **Legislative Division of Post Audit**

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# **PERFORMANCE AUDIT REPORT**

## **DEPARTMENT OF REVENUE'S DELINQUENT TAX COLLECTION PROCESS**

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### **OBTAINING AUDIT INFORMATION**

This audit was conducted by Mary Beth Green, Senior Auditor, and Cindy Denton and Murlene Priest, Auditors, of the Division's staff. If you need any additional information about the audit's findings, please contact Ms. Green at the Division's offices.

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# DEPARTMENT OF REVENUE'S DELINQUENT TAX COLLECTION PROCESS


## Summary of Legislative Post Audit's Findings

Previous performance audits we conducted have shown that the Department of Revenue's tax collection efforts were inadequate and inefficient, and that its enforcement efforts were sometimes lax. Under provisions of the Kansas Sunset Act, the Department of Revenue is scheduled for sunset review in 1989. As part of that review, we were directed to examine the Department's recently developed procedures for collecting delinquent taxes.

**How much in delinquent taxes is owed to the State?** The Department of Revenue's records showed that taxpayers owed the State approximately \$71 million for delinquent sales, withholding, and individual income taxes in the fall of 1988. Delinquent corporate income taxes were not included in this figure because accurate estimates were not available. The \$71 million figure may be overstated because it included estimated amounts due from some taxpayers, as well as amounts that may never be collected. In general, most taxpayers appeared to pay their taxes on time. However, the percentage of delinquent taxes was higher in 1987 than it was in 1981. Further, it appears that the Department is less successful in collecting delinquent taxes the longer they have been outstanding.

**Do recent changes within the Department of Revenue appear to be sufficient to address its tax collection problems?** The Department's primary action to address its tax collection problems was establishment of the Division of Collections in November 1987. One year later, the Division was responsible for collection attempts on approximately 70,700 delinquent accounts with outstanding balances of more than \$74.3 million. The new Division has addressed some tax collection problems by using more consistent and aggressive collection procedures than the procedures used before the Division was established. However, we found that Division personnel were not always following those aggressive and consistent procedures for a sample of taxpayer accounts. As a result, the Division did not use all its available collection remedies in a timely manner. In addition, some previously identified problems—such as ineffective bonding practices—were not addressed by creating the Division of Collections. Finally, the Division plans to further enhance its collection procedures by obtaining an automated collection system in fiscal year 1989. Because this system will not be fully operational until fiscal year 1990, we could not specifically determine how effective it will be.

This report includes recommendations for improving the accuracy of the Department of Revenue's delinquent tax information and for maximizing collections of delinquent taxes. We would be happy to discuss these recommendations or any other items in the report with legislative committees, individual legislators, or other State officials.

  
Meredith Williams  
Legislative Post Auditor



## **DEPARTMENT OF REVENUE'S DELINQUENT TAX COLLECTION PROCESS**

Under provisions of the Kansas Sunset Act, the Department of Revenue was scheduled for sunset review in 1989. As part of that review, the Legislative Division of Post Audit was directed to review the Department's recently developed procedures for collecting delinquent taxes.

Previous audits we conducted have shown that the Department's tax processing and collection efforts were inadequate and inefficient, and that its enforcement efforts were sometimes lax. For example, a 1982 audit showed that the Department gave blanket extensions for filing retailers' sales and withholding tax returns. This practice cost the State about \$233,000 in foregone interest earnings for fiscal year 1981. A 1986 audit found that the Department had collected only \$49,000 of \$545,000 in delinquent taxes owed by a sample of 50 retailers who had gone out of business.

A Departmental reorganization subsequently created the Division of Collections in November 1987 to centralize collection activities regarding delinquent taxes. The 1988 Legislature approved funding for an automated collection system designed to replace certain manual processing procedures and provide collectors with integrated lists of taxpayers' delinquent accounts.

This audit reviewed tax collection procedures used by the Division of Collections and addressed these questions:

- 1. How much in delinquent taxes is owed to the State?**
- 2. Do recent changes within the Department of Revenue appear to be sufficient to address its tax collection problems?**

To answer these questions, we reviewed the Department's records concerning delinquent amounts owed to the State for the four major taxes—sales, withholding, and individual and corporate income taxes—as well as information about accounts that have been referred to the Division of Collections. We also interviewed Department personnel and examined the Division of Collections' procedures for collecting amounts due from delinquent taxpayers. We then examined the Division's actual collection efforts for a sample of accounts. Finally, we reviewed proposed future enhancements for the Division including the automated collection system.

Department of Revenue records showed that taxpayers owed the State approximately \$71 million for past due sales, withholding, and individual income taxes in the fall of 1988. (Accurate estimates of delinquent corporate income taxes were not available.) This total includes the Department's estimates of overdue taxes and penalties from some taxpayers, as well as some delinquent taxes that may not be collectable. We found that, between 1981 and 1987, the amount of delinquent taxes at year-end grew more rapidly than the amount of taxes collected during the year for

sales, withholding, and individual income taxes. In addition, the Department's ability to collect delinquent taxes appeared to decline the longer the delinquencies had existed.

We also found that the new Division of Collections' policies for collecting delinquent taxes were more aggressive than the Department's past policies and procedures. These new policies addressed some problems identified in our previous audits. In reviewing a sample of accounts, however, we found that the Division did not always follow those procedures and use the available collection methods in a timely manner. To further improve collections, the Division plans to obtain an automated collection system in fiscal year 1989. Although this is a major change to the collections process, we could not specifically determine how the system would enhance collections because it was not installed and operating at the time of the audit.

## **How Much in Delinquent Taxes Is Owed to the State?**

Department records for the total delinquent taxes for sales, withholding, individual income, and corporate income taxes showed that taxpayers owed the State about \$238 million in overdue taxes in the fall of 1988. According to Department officials, however, this total was significantly overstated because it included \$167 million for overdue corporate income tax. The \$167 million included estimated amounts due from corporations based on the Department's audit assessments. If a corporation disagrees with that assessment, it can appeal to the Department. According to Department officials, the amounts due are often reduced substantially after the appeals process.

Because the Department could not provide accurate estimates for delinquent corporate income tax, we excluded that tax from our analysis. The three other major taxes accounted for an estimated \$71 million in delinquent taxes owed.

### **Taxpayers Owed the State Approximately \$71 Million For Past Due Sales, Withholding, and Individual Income Taxes in Fall 1988**

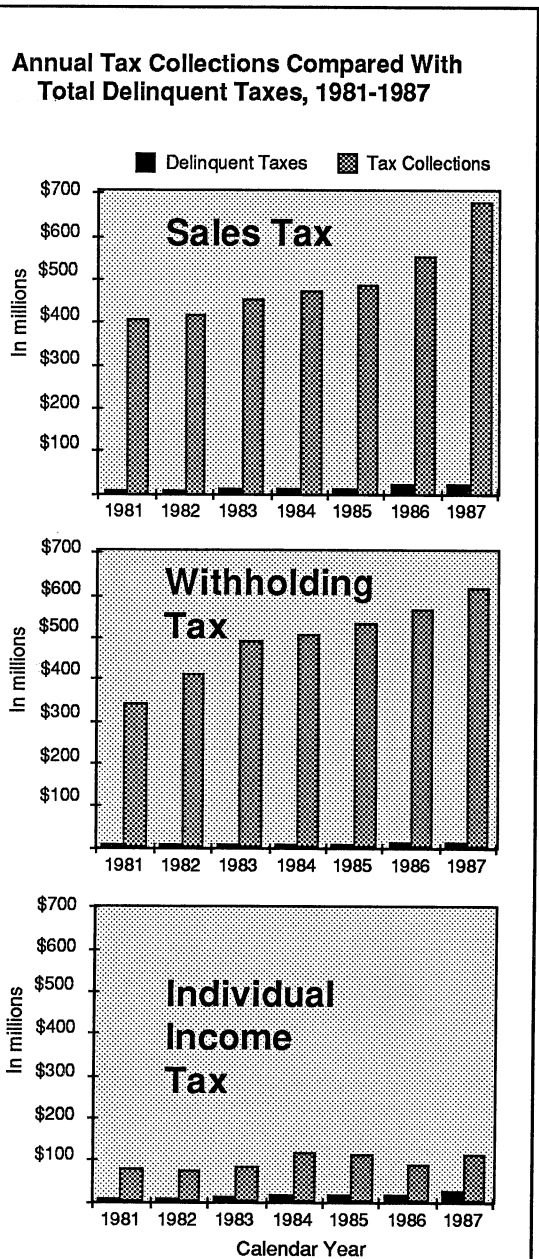
Our comparison of actual tax collection figures with the amounts of outstanding taxes owed showed that most business taxpayers have remitted their taxes to the Department on time. For example, sales taxes outstanding at the end of calendar year 1987 equalled approximately \$24.3 million, or 3.6 percent of the \$674 million in sales tax collected that year. Outstanding withholding taxes were less than two percent of the withholding taxes collected.

Although the majority of individuals paid their taxes on time as well, the percentage that did not was somewhat higher. Individual income taxes outstanding and owed at the end of calendar year 1987 totaled nearly 25 percent of collections. The Department's tax collection and delinquent tax figures for sales, withholding, and individual income tax for 1981 and 1987 are summarized in Appendix A. The delinquent tax figures noted here for all three types of taxes represent cumulative totals; that is, they include taxes that first became delinquent in 1987 and taxes that may have been delinquent before that.

The Department of Revenue establishes accounts receivable, or delinquent amounts, when taxpayers do not submit tax returns, submit returns without complete tax payments, submit insufficient funds checks, submit returns and payments after the due date, or submit returns with errors. Accounts receivable are also established when Department personnel audit taxpayers and determine that those taxpayers owe additional taxes.

In the fall of 1988, the Department's records indicated that delinquent sales, withholding, and individual income taxes equalled about \$71 million. This figure included \$29.4 million for sales tax, \$12.7 million for withholding tax, and \$28.9 million for individual income tax. (The totals for sales and individual income tax were

as of November 30, and the total for withholding tax was as of October 30.) These figures also represent cumulative totals of delinquent taxes.



As these charts illustrate, most business taxpayers remitted their sales and withholding taxes on time. For these two taxes, the total amount of taxes delinquent represented a small percentage of the amount collected in any year. Delinquent income taxes were higher; for example, they totaled nearly 25 percent of the amount collected in 1987.

The Department's estimates of delinquent taxes owed may be somewhat overstated because the figures included both estimates of taxes due and amounts that may never be collected. Because some of the Department's delinquencies occur when taxpayers do not file their tax returns and remit the taxes owed, the Department's delinquent tax amounts include estimates for such taxpayers and the associated penalty and interest charges. These estimates may be higher than the actual amount a taxpayer owed, and when the taxpayer files a delinquent return, the actual amount due and paid may differ from the previously estimated amount. As a result, the Department's estimates of delinquent taxes may not accurately reflect the amounts that may be collected in the future.

In addition, the Department's delinquent tax figures include amounts that the Department will never collect because some taxpayers do not have any resources to pay their debts. When accounts are considered to be uncollectable, generally accepted accounting principles indicate that they should be "written off" rather than carried on the books as assets and expected future revenues. The purpose of writing off accounts is to recognize which accounts cannot be collected, and to provide accurate accounting estimates of future revenues from the current delinquencies. Writing off accounts is also a useful management tool for ensuring that collection resources are not wasted on accounts that probably will never be collected.

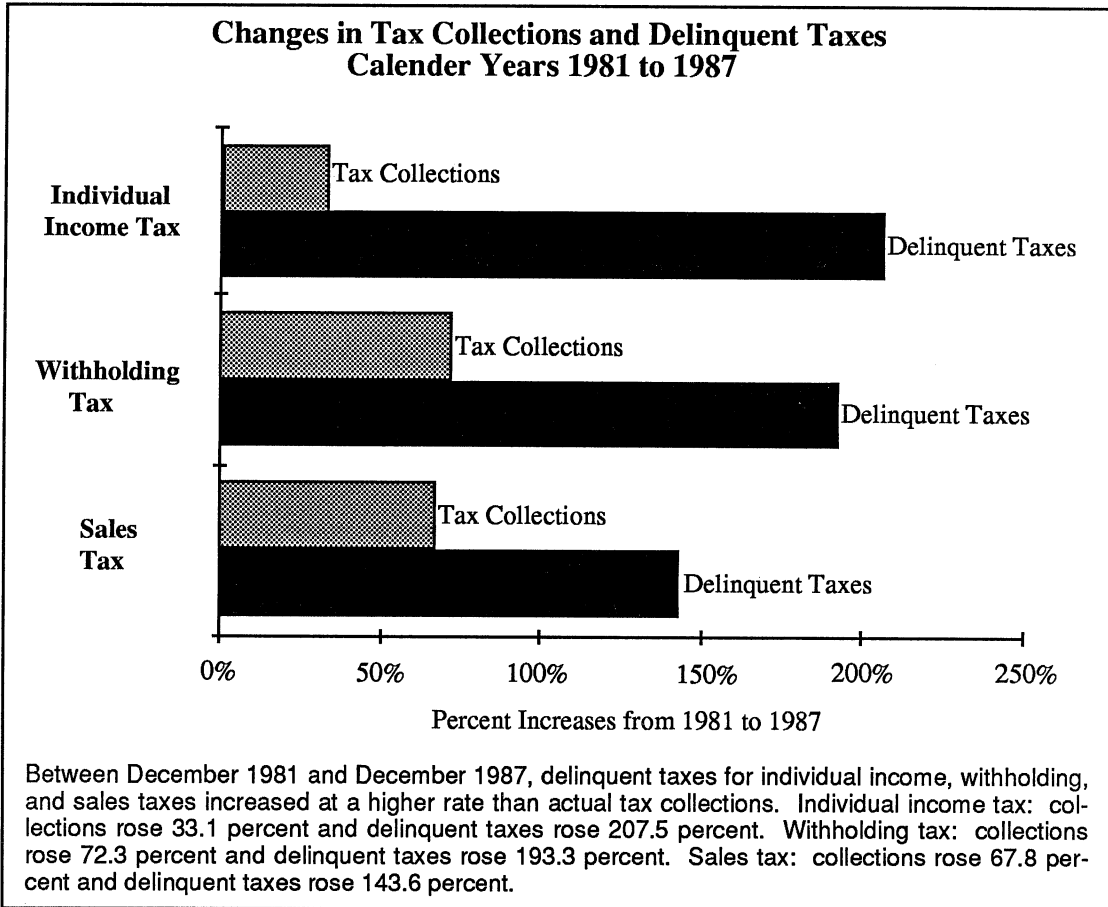
Writing off accounts is an accounting concept that removes those accounts from an agency's accounting records but does not cancel the debtor's legal obligation or

preclude the State from accepting payment at a later date. The Department's policy is to write off accounts after seven years have passed without any transactions. This policy allows uncollectable accounts to remain on the Department's books, which overstates possible future revenues from delinquent taxpayers.

**As a Percentage of Annual Collections, More Taxes Were Delinquent In 1987 Than In 1981**

The amounts of overdue sales, withholding, and individual income taxes from 1981 to 1987 are compared with tax collections in the charts on the facing page. As noted earlier, these delinquent amounts represent delinquent taxes that have accumulated over time; they do not represent the percentage of collections that became delinquent that year.

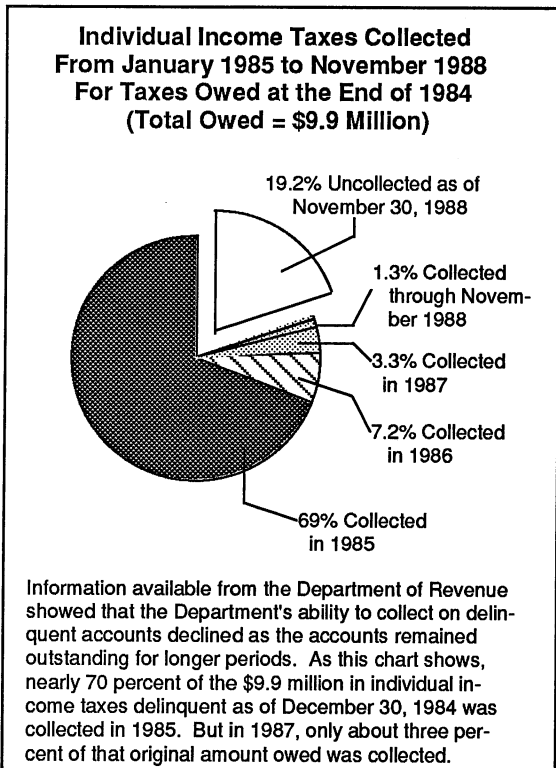
As the charts show, both tax collections and delinquent taxes have increased since 1981. However, the overdue taxes have increased more rapidly. This means that as a percentage of tax collections, more taxes were delinquent in 1987 than were delinquent in 1981. For the three taxes we analyzed, the increase was most significant for individual income tax. Individual income tax collections increased from \$75.4 million in calendar year 1981 to \$100.4 million in calendar year 1987, or a 33.1



percent increase. At the same time, outstanding individual income taxes owed increased 207.5 percent, from \$8 million to \$24.7 million. The rates of increase for the three taxes we reviewed are illustrated in the chart on page five.

### The Longer Delinquent Taxes Remained Uncollected, The Less Likely the Department Was to Collect On Them

Because delinquent taxes generally become more difficult to collect as time passes, we attempted to determine how long the Department's delinquent taxes had been overdue. We found, however, that the Department had this information only for sales and individual income tax. Further, Department officials indicated that the available information was not entirely accurate because the Department classified the age of the account according to the length of time it had been in a particular collection activity (such as with a field agent, with a bankruptcy claim filed, or the like), rather than on how long it has actually been delinquent.



The available information for sales and individual income tax did show that the Department's ability to collect on delinquent accounts appeared to decline as the accounts remained outstanding for longer periods. For example, on December 31, 1984, Department records listed \$9.9 million in delinquent individual income taxes that were less than one year old. During calendar year 1985, the Department collected or adjusted \$6.8 million of the delinquent \$9.9 million. The Department was much less successful from 1986 through 1988; it collected only an additional \$1.2 million of the delinquent \$9.9 million. These collections are illustrated in the accompanying pie chart.

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#### Recommendation

To help ensure that its accounts receivable records more accurately reflect delinquent taxes that are collectable and the length of time taxes have been delinquent, the Department of Revenue should do the following:

- a. Obtain or develop an accounts receivable system that would record the actual length of time accounts have been delinquent.

- b. Develop new policies and procedures for writing off accounts when they become uncollectable rather than waiting to write off accounts after seven years have passed without any activity.

## **Do Recent Changes Within the Department of Revenue Appear To Be Sufficient To Address Its Tax Collection Problems?**

The Department of Revenue established the Division of Collections in November 1987. Within a year, the Division was responsible for collection attempts on approximately 70,700 delinquent accounts with outstanding balances totalling more than \$74 million.

We determined that the new Division had established policies and procedures for collecting delinquent taxes which addressed some of the Department's tax collection problems and which were more consistent and aggressive than procedures used before the Division was created. However, our testwork also showed that the Division did not always follow its formal procedures. In addition, some previously identified tax collection problems—such as ineffective bonding procedures—were not resolved by creating the Division of Collections. At the time this audit was conducted, the Division also was reviewing bids from contractors for an automated collection system to change and enhance its collection activities. Division officials expect that actual work on the system will begin in fiscal year 1989, but the system will not be completed until fiscal year 1990.

Because of the large number and age of the accounts the Division has initially been given to handle, the relative newness of the Division, and the fact that the automated collection system has not been implemented, it is difficult to conclude at this point about how effective the changes ultimately will be in enhancing the Division's collection efforts.

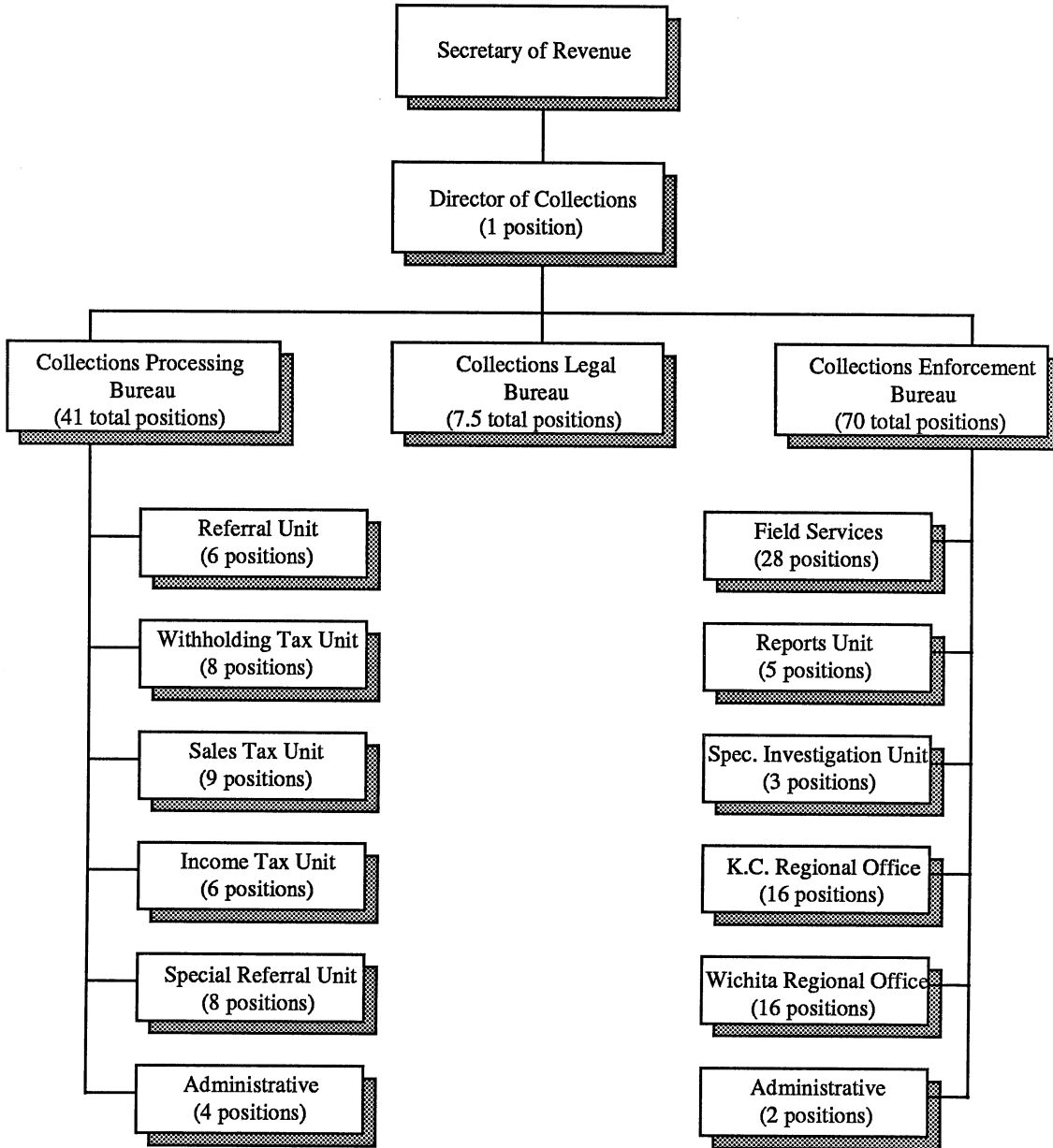
### **The Department Established the Division of Collections in November 1987 To Help Address Its Tax Collection Problems**

According to Department officials, the Division of Collections was established "to provide for centralized and progressive action in the collection of delinquent taxes and the effective management of accounts receivable." The Department decided to combine many of the responsibilities for collecting delinquent taxes into this one Division, rather than having several bureaus handle collections of different types of taxes or different aspects of delinquent tax collections.

To staff the new Division, the Department identified personnel such as tax examiners, field agents, and attorneys in various Department bureaus and divisions who historically had collection responsibilities. These individuals were then reassigned to the Division, thereby concentrating and standardizing the Department's collection activities.

The Division had 119.5 personnel positions for fiscal year 1989. This figure included personnel in the Division's three main bureaus: Collections Processing, Collections Enforcement, and Collections Legal. The Division's personnel are located in the main office in Topeka and regional offices in Kansas City and Wichita. Division

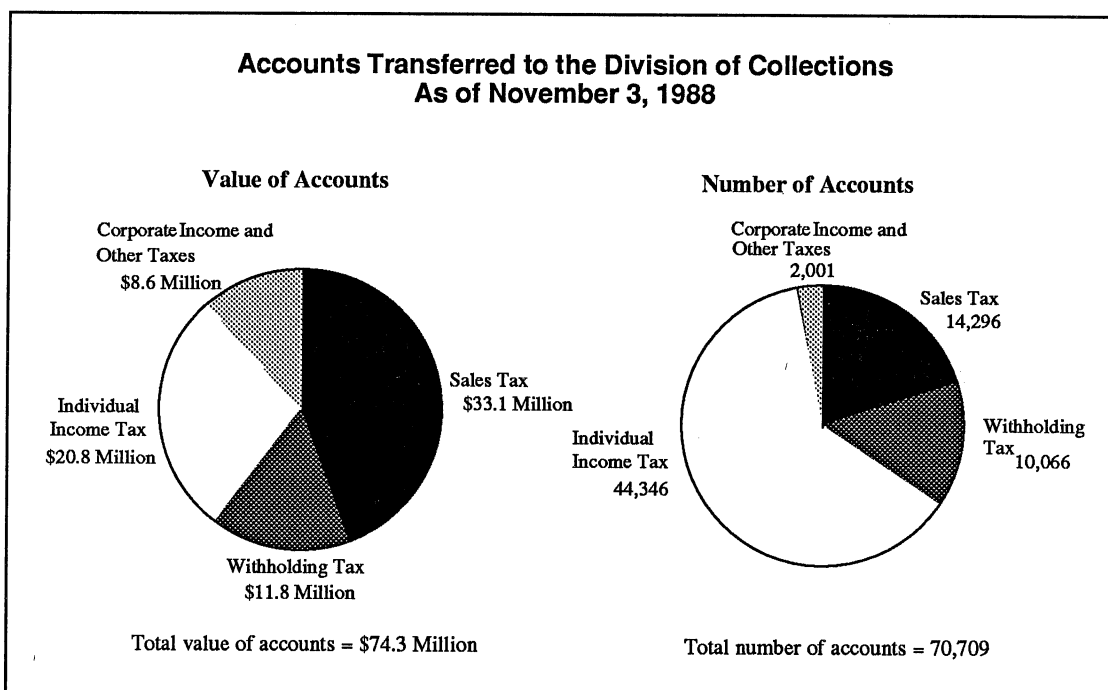
## Organization of the Division of Collections



To provide consistency and centralized control of the collection function, the Division of Collections was divided into three bureaus: Collections Processing, Collections Legal, and Collections Enforcement. To fulfill the goal of consolidating collections processing, tax examiners, field representatives, attorneys, and additional support personnel were transferred from other bureaus in the Department of Revenue to fill the three new bureaus in the Division. In fiscal year 1989, the Division had 119.5 personnel positions.

personnel also include 31 field agents who work out of their homes across the State. These field agents, and the field agents assigned to the regional offices, often are responsible for personally contacting taxpayers who did not respond to collection letters and telephone calls.

As of November 1988, the Division of Collections was responsible for approximately 70,700 accounts with outstanding balances of \$74.3 million. This figure included \$33.1 million for sales tax, \$11.8 million for withholding tax, \$20.8 million for individual income tax, and \$8.6 million for other taxes such as corporate income, liquor enforcement, compensating use, and bingo excise taxes. The Division's accounts are summarized by tax type in the following pie charts. As the charts show, overdue sales, withholding, and individual income taxes accounted for most of the Division's outstanding accounts.



**The Department Has Streamlined Its Delinquent Tax Collection Process and Adopted Collection Procedures That Should Help Improve Its Tax Collection Efforts**

Previous performance audit reports we issued in 1982 and 1986 showed that the Department did not always take prompt and aggressive actions to collect delinquent taxes. Those audits generally indicated that the Department needed to improve its procedures for following up on delinquent sales and withholding tax accounts. They included numerous recommendations for improvements in procedures for identifying delinquent accounts, managing tax remittance cycles, and following up on delinquent accounts. A detailed list of those recommendations and their current status is included in Appendix B.

In this audit, we concentrated on changes in the Department's procedures for following up on delinquent accounts, particularly those procedures used by the Division of Collections.

**The Department's consolidation of delinquent tax collection activities within the Division of Collections has streamlined that process.** Before the Division of Collections was established, for example, delinquent accounts had to be transferred from the Division of Taxation to the Division of Operations before a field agent could contact a taxpayer and attempt to collect the delinquent amount. If legal questions arose, the account generally had to be transferred to the Department's Legal Bureau. Now, these staff are all consolidated within the Division of Collections. Taxpayers who do not submit their tax returns and taxes on time receive written notices from the Department of Revenue's Division of Operations, and the delinquent taxpayers then have approximately 30 days to respond to the notice. Taxpayers who do not respond within 30 days then are generally referred to the Division of Collections.

**The Department and the Division have adopted formal collection procedures.** The Division has separate procedures for the different types of taxes, but many procedures are used for all delinquent taxes. Those procedures include the following:

- **Statements and personal contact.** After an account is referred, Division personnel try to contact the taxpayer through a letter, telephone call, or personal visit from a field agent.
- **Appearance notices.** If the account is not collected after the statement or personal contact, the Division sends the taxpayer a notice to appear to reconcile the tax liability. Normally, the taxpayer is requested to appear and discuss the delinquency with one of the Division's field agents.
- **Payment plans.** At any time in the collection process, the taxpayer may ask to make payments under a payment plan. Based on the taxpayer's financial status and the amount owed, the Division may approve a payment plan and allow the taxpayer to make monthly payments to retire the debt. If a taxpayer defaults on a payment plan, Division personnel proceed with other collection actions. The Division charges interest during the life of payment plans, at an annual rate of 18 percent.
- **Collection agencies.** The Division refers delinquent taxpayers who live in other states to a collection agency when the delinquency is more than 60 days old. The collection agency uses its own collection options on the account and retains 18 percent of any money collected.
- **Tax warrants.** Tax warrants are legal notices authorizing officials to seize and sell real and personal property to satisfy tax delinquencies. The Division issues tax warrants and sends them to county sheriffs. The sheriffs file them with clerks of the district courts; filed warrants become judgments against taxpayers and liens upon real property. State law requires the Division to issue a tax warrant if the tax liability is not paid within 60 days of the due date.
- **Penalties and interest charges.** Delinquent taxpayers may be charged interest on the overdue amount, as well as penalties for failing to file returns or remit taxes. The Division will only waive interest charges if the Department of Revenue makes an error. The Division only waives penalties when taxpayers have not had any other delinquencies during the last three years or when the delinquency results from circumstances beyond the taxpayers control, such as death or serious illness of the responsible party.

- **Garnishments.** The Division's Legal Bureau garnishes wages and income of taxpayers to satisfy debts. State law does not allow the Division to use garnishments until after a tax warrant has been filed.
- **Department of Administration's set-off program.** This computerized set-off program matches identifying information for debtors, such as Social Security numbers and Federal Employer Identification numbers, with State payments such as State employee payroll checks, State tax refunds, and State payments to vendors. As of January 1989, the Division was submitting some delinquencies to the State's set-off program for collection but did not do so routinely. Division officials indicated that they planned to start routinely submitting automated lists of individual income tax delinquencies with tax warrants that were more than one year old to the Department of Administration in February.
- **Revocations of registration certificates.** For delinquent sales tax accounts, the Division may request that the Division of Taxation revoke the retailer's registration certificate. It is unlawful for a retailer to make sales without a valid registration certificate.
- **Injunction proceedings.** For sales and withholding tax delinquencies, the Division files petitions for injunctions prohibiting the businesses from operating. Injunction petitions are filed with the district courts. For sales tax accounts, injunctions are only filed after registration certificates have been revoked.
- **Seizing bonds.** The Department's Division of Taxation is responsible for requiring taxpayers to post bonds. However, if a delinquent taxpayer who has been referred to the Division of Collections has posted a bond, the Division of Collections will claim the bond. Bonds are generally only required on sales tax accounts, and Department policy is to only seize bonds after businesses have closed regardless of any delinquencies.
- **Bankruptcy claims.** Once a taxpayer declares bankruptcy, federal law prohibits the Division from attempting further collection activities. The Division files tax claims in bankruptcy cases and waits for the courts to resolve the cases.

The Division of Collections has also established guidelines for determining which accounts Division personnel should concentrate on collecting. The Division

#### **Delinquent Sales Tax Resulting From Unreported Income**

The Department of Revenue does not always identify delinquent taxpayers because they fail to file returns or make errors. In December 1987, a letter from the state of Missouri alerted the Department to a possible problem with a retailer's sales tax account. The Department audited the retailer's past three years of operations. The audit revealed that the taxpayer appeared not to have reported all income; the Department assessed almost a quarter of a million dollars in back taxes, penalty, and interest. The Division of Collections filed warrants and garnishments in attempts to collect. To counter these collection efforts, the taxpayer is appealing the assessment; the district court has granted a restraining order to prevent collection attempts while the Board of Tax Appeals hears the case.

attempts to collect all delinquencies of more than \$100, but gives priority to collecting delinquent taxes that exceed certain minimum balances. For example, the Division gives first collection priority to delinquent sales tax accounts with balances of more than \$25,000 and to delinquent individual income tax accounts with balances of more than \$5,000. In addition, the Division has developed a written guide for its staff to use when attempting to collect delinquent taxes. This document provides consistent guidelines for staff members to use in various circumstances, such as following up on a broken promise from a taxpayer and working with delinquent taxpayers who are unemployed.

Our review of those collection procedures showed that they appear to be more aggressive than past procedures and should help address some of the previously identified problems. The Division's collection procedures appeared adequate to provide for aggressive and consistent actions against delinquent taxpayers. The Division has also established a system for identifying which accounts should be worked first, which appeared to be a good use of their available resources at this time.

**Some aspects of the Department's and the Division's collection procedures could still be improved, either by the agency or through changes in State law.** In reviewing the Division's procedures, we concluded that the following procedures or actions could further enhance delinquent tax collections:

- State law limits the Division's use of collection agencies to collections from out-of-State residents. We found that the Division's current use of a collection agency for out-of-State accounts was cost-effective because the agency was only paid when it actually collected money.
- Division officials plan to submit automated lists of individual income tax delinquencies with tax warrants that were more than one year old to the Department of Administration's set-off program in February. Because this action had not been taken when the audit was conducted, we could not determine how effective it will be. Because the Department of Revenue's ability to collect accounts appears to decline the longer accounts remain uncollected, however, Division personnel may want to reevaluate the time frame for submitting accounts for set-off.
- The Division currently does not have a procedure to identify new accounts that are transferred to the Division from other areas in the Department. As a result, the Division cannot systematically give recent delinquencies collection priority. As pointed out earlier in the audit, newer delinquent accounts have the potential for being more collectable. As discussed later, the planned automated collection system will address this problem, but an interim procedure for earmarking new delinquent accounts would be helpful.
- In addition, some other previously identified weaknesses in the Department's tax collection process have not been addressed or improved by the creation of the Division of Collections. The Department attempted to address one of these problems—bonding requirements—but changes in State law subsequently weakened the Department's bonding policies. Our previous audits found that the Department did not require enough businesses to post bonds and did not require adequate bond amounts to satisfy delinquencies. In 1986, the Department strengthened its sales tax bonding requirements. The 1988 Legislature, however, amended State law to require the Director of Taxation to have documented evidence that taxpayers were probable risks for collecting and remitting taxes before a bond could be required. On July 1, 1988, the Department began requiring bonds only from taxpayers with some history of delinquencies.

### **Taxpayer Volunteers to Pay Delinquent Taxes**

In April 1988, the Department of Revenue received a letter from a taxpayer who indicated that he had not filed his income tax returns nor paid taxes for 1982 through 1987. Before receiving the letter, the Department had not identified this delinquency nor attempted to collect the overdue taxes. Tax returns, without tax payments, were enclosed with the letter.

The taxpayer offered to make monthly payments, and the account was referred to the Division of Collections. Division personnel reviewed the returns submitted by the taxpayer and concluded that he owed approximately \$5,600 in delinquent taxes, penalty, and interest. The taxpayer made monthly payments of \$100 in October and November 1988. As of January 1989, the Division had not finalized the taxpayer's payment plan; Division personnel were still reviewing the case to determine whether to require monthly payments of \$100 or \$200.

In reviewing a sample of delinquent accounts at the Division of Collections, we found that Division personnel did not always follow the established procedures in a timely manner. We reviewed a sample of 25 sales tax accounts with balances of more than \$25,000 and 25 individual income tax accounts with balances of more than \$5,000 to determine what actions the Division had taken on the accounts between November 1987 and January 1989.

We found that the Division did not always follow its formal collection procedures and did not always take collection steps within the time frames specified in those procedures. For the 50 accounts reviewed, we found the following:

- The Collections Enforcement Bureau's field agents did not complete their collection actions within 60 days of receiving the account in 11 of 20 applicable cases, as required by Division policy.
- The Collections Processing Bureau had not completed processing payment plan requests in two of six applicable cases; both requests had been made by taxpayers in September 1988.
- The Collections Processing Bureau did not refer eight of nine eligible accounts to the collection agency that handled delinquencies for out-of-State residents.
- The Collections Enforcement Bureau did not file 18 of 27 tax warrants promptly.
- The Collections Legal Bureau delayed four of eight possible garnishments for no documented reason.
- The Collections Legal Bureau did not file two of five bankruptcy claims promptly, and Division personnel did not know if another claim had been filed because the taxpayer's file had been destroyed.

The problem with these failures to act promptly and aggressively, is that they reduce the Division's chances of collecting on overdue amounts. Division personnel indicated that many of the delays we identified were caused by the large inventory of accounts that had been assigned to the Division and by the length of time many of the accounts had been delinquent. We did verify that most of the accounts in our sample had been delinquent before the Division of Collections was even established. For ex-

ample, 21 of the 25 individual income tax accounts were for delinquencies from 1986 and previous tax years. The remaining four accounts were delinquent for the 1987 tax year (the taxes generally should have been remitted to the Department by April 15, 1988), but all four accounts included delinquencies for previous years as well.

**The Division collected delinquent taxes from only 11 of the 50 taxpayers in our sample.** On those 11 accounts, the Division collected a total of \$25,230. This money was collected from various sources, as outlined below:

- \$16,775 from bonds from three accounts
- \$6,697 from direct payments from taxpayers on three accounts
- \$829 from garnishments of one taxpayer's wages
- \$650 from payments under payment plans for two accounts
- \$279 from two accounts submitted to the Department of Administration's set-off program.

Because the likelihood of collecting delinquent taxes decreases the longer accounts remain uncollected, we could not determine whether the Division's collections on our sample accounts were limited by its failures to follow established procedures or by the age or other circumstances of those accounts.

#### **Some Accounts Referred to the Division of Collections Have Been Delinquent for Years**

In our sample of 50 accounts, we found accounts that had been delinquent for several years. One taxpayer, for example, owed approximately \$18,500 in individual income taxes for tax years 1980 through 1984. The Division of Collections began working on this account in August and September 1988 by trying to locate the taxpayer. Division personnel could not locate the taxpayer and could not identify any current Kansas wages being paid to the taxpayer. In October 1988, the Division had a county sheriff file a tax warrant, but had not collected any money from the warrant as of December 1988. The Division did not plan any further collection attempts on this account because it had been delinquent for years and the taxpayer could not be located.

Another taxpayer filed for bankruptcy in 1985, owing the Department about \$38,750 for delinquent sales taxes for 1984 and 1985. At that time, the Department filed a claim in the bankruptcy for the delinquent amount. This account was transferred to the Division of Collections in 1988. The Division does not plan to take further action because the amount due is covered by the claim and federal law prohibits other collection actions in bankruptcy cases.

#### **Out-of-State Collections**

K.S.A. 75-5140 gives the Secretary of Revenue authority to contract with debt collection agencies to collect delinquent taxes from nonresident taxpayers. The Department of Revenue contracts with GC Services, Inc. for collections from out-of-State delinquent taxpayers for all tax types.

Under that contract, the Department's Division of Collections notifies taxpayers before turning an account over to GC Services. The collection agency then attempts to contact the taxpayer and collect the amount due. If the taxpayer cannot be located or is unable to pay the debt, GC Services returns the account to the Division after six months. If GC Services collects any delinquent taxes, the agency receives a commission of 18 percent of the actual collections.

GC Services has collected \$549,537 on cases assigned to the company from 1986 through December 1988 and received \$97,916 in commissions for its services. As a result, the Department has received \$5.61 in delinquent tax for every \$1 in commissions paid for that period. Using GC Services appears to be a cost-effective method of tax collection for the State since payment to the collection agency is based on actual collections rather than the volume of accounts assigned for collection.

We also tried to look at the total amount of delinquent taxes the Division had collected, but were unable to obtain figures from the Wichita and Kansas City field offices because they did not separate current and delinquent tax collections. Even excluding these two offices, the Division's collections for the first five months of fiscal year 1989 were about \$4.5 million, compared with budgeted expenditures for the period of less than \$1.3 million. Thus, the Division collected at least \$3.57 for every dollar budgeted to be spent.

### **The Department Plans To Further Enhance Collection Procedures With an Automated Collection System**

The Department of Revenue's planned enhancements for the Division of Collections include acquisition of an automated collection system. Such a system consists of computer hardware and software that will be used to manage taxpayer accounts and provide management information.

#### **Proposed Regional Offices**

The Division of Collections currently has two regional offices in Wichita and Kansas City with 12 field agents in each office. Most of the Division's field agents, 31, work out of their homes across the State. In the future, the Division would like to establish five additional regional offices and relocate the 31 field agents to those offices. The location of the offices would be based on the number of accounts per county and proximity to taxpayers for public service purposes.

The regional offices would provide field agents with account information through computer terminals. Under the existing system, agents do not always have access to complete and current account data. According to Division officials, the increased cost of the offices could be minimized by sharing office space with other governmental units and agencies. The actual cost for the additional regional offices has not been projected, and since the proposal has not been approved, no implementation dates have been set.

In November 1988, the Department issued a request for proposals from contractors on the software for an automated collection system. Three contractors submitted complete or partial bids on the system in January 1989, and the Department plans to award the contract in February 1989. Division of Collections' officials indicated that they expect the contractor to begin working on the system in fiscal year 1989, but that they do not expect the system to be completed until fiscal year 1990. The 1988 Legislature authorized the Department to spend a maximum of \$1.5 million on the system, which will be paid for through increased collections generated by the system.

According to Division officials and our review of the request for proposals, the automated collection system is intended to eliminate duplication of effort and to reduce the volume of paperwork now involved with the collections system. The request for proposal specifies that the system's software must perform many functions. These include the ability to :

- record the date the account becomes delinquent and the dates of collection actions
- provide automatic scheduling and assignment of accounts based on criteria established by the Division
- track payment plans automatically

- route accounts that have exceeded a defined number of “no” answers and broken promises to management personnel for review, and schedule the corresponding accounts for appropriate actions
- assign and track selected accounts to the out-of-State collection agency.

The system will schedule work continuously throughout the day, according to rules established by the Division. The system should also support telephone and field agent collection efforts. It will be designed to prompt the collector as to actions to be taken, provide all information on promises to pay, and enable immediate updating of the account following contact with the delinquent taxpayer. According to Division personnel, the system will integrate all the Division’s delinquent taxpayer accounts using Federal Employment Identification and Social Security numbers.

Although it appears the automated collection system should improve the Division’s procedures for collecting delinquent accounts, the system had not been purchased or installed when we conducted this audit. As a result, we could not determine how effective the system will be.

### Conclusion

Although most taxpayers appear to remit their taxes to the Department of Revenue on time, overdue taxes have increased since the early 1980s. To help address its tax collection problems, the Department established the Division of Collections in November 1987. It also plans to obtain an automated collection system to help record and track tax information, schedule work, and integrate delinquent tax accounts.

As of January 1989, the Division’s collection system appeared to be more aggressive and consistent than the Department’s previous procedures. However, our sample review showed that the Division did not always follow its formal collection procedures or take appropriate collection steps within the times specified. Under those circumstances, the potential the new procedures offer for improving the Division’s collection efforts cannot be fully realized. Other changes could be made as well in the current laws or procedures to enhance those collection efforts. The existing descriptions of the automated collection system provide some indication that the system should enable the Department to more effectively use the available collections options. But because the proposed system apparently will not be fully operational until 1990, we could not determine how effective it may be.

## **Recommendations**

1. To ensure that collection attempts for delinquent taxes are made in a timely manner, the Department of Revenue's Division of Collections should take collection actions within the time frames specified in its established procedures.
2. To maximize collections of delinquent taxes until the automated collection system is implemented, the Division of Collections should enhance its procedures for identifying accounts with collection priority by:
  - a. including the length of time an account has been delinquent in the priority system,
  - b. developing procedures to identify new delinquent accounts when such accounts are transferred to the Division.
3. To maximize collections on delinquent accounts that are not given collection priority by the Division, the Division should consider the following:
  - a. submitting those delinquent accounts to the Department of Administration for inclusion in the State's set-off program,
  - b. seeking legislation to allow the Division to send those accounts to a collection agency for collection attempts.
4. Because the automated collection system will play such a pivotal role in the Department's plans for improving its tax collection efforts, the Legislature should consider requesting a performance audit of that system's effectiveness after it has been fully installed and has been in operation long enough to evaluate it.

## APPENDIX A

### Department of Revenue's Annual Tax Collections And Cumulative Delinquent Taxes Calendar Years 1981 Through 1988

#### Sales Tax

| Year                          | Accounts<br>Receivable | Total Tax<br>Collections | Receivables as a<br>Percent of Collections |
|-------------------------------|------------------------|--------------------------|--|
| 1981                          | \$ 9,983,517           | \$ 401,751,991           | 2.5%                                       |
| 1982                          | 11,833,492             | 413,710,687              | 2.9  |
| 1983                          | 15,418,350             | 443,322,109              | 3.5  |
| 1984                          | 16,304,735             | 469,525,193              | 3.5  |
| 1985                          | 18,733,352             | 491,555,709              | 3.8  |
| 1986                          | 24,342,924             | 561,114,930              | 4.3  |
| 1987                          | 24,321,429             | 674,262,381              | 3.6  |
| 1988(a)                       | 29,399,993             | 638,803,902              | 4.6  |
| <b>% Increase, 1981-87(c)</b> | <b>143.6 %</b>         | <b>67.8%</b>             |  |

#### Individual Income Tax

| Year                          | Accounts<br>Receivable | Total Tax<br>Collections | Receivables as a<br>Percent of Collections |
|-------------------------------|------------------------|--------------------------|--|
| 1981                          | \$ 8,046,152           | \$ 75,423,733            | 10.7%                                      |
| 1982                          | 8,318,174              | 73,288,480               | 11.4                                       |
| 1983                          | 10,489,708             | 81,131,761               | 12.9                                       |
| 1984                          | 16,335,625             | 113,710,878              | 14.4                                       |
| 1985                          | 16,053,174             | 110,911,607              | 14.5                                       |
| 1986                          | 18,570,862             | 87,625,151               | 21.2                                       |
| 1987                          | 24,737,924             | 100,402,873              | 24.6                                       |
| 1988(a)                       | 28,876,258             | 159,582,555              | 18.1                                       |
| <b>% Increase, 1981-87(c)</b> | <b>207.5%</b>          | <b>33.1%</b>             |  |

#### Withholding Tax

| Year                          | Accounts<br>Receivable | Total Tax<br>Collections | Receivables as a<br>Percent of Collections |
|-------------------------------|------------------------|--------------------------|--|
| 1981                          | \$ 4,118,912           | \$ 363,863,591           | 1.1%                                       |
| 1982                          | 5,262,095              | 412,184,727              | 1.3  |
| 1983                          | 7,040,378              | 498,030,859              | 1.4  |
| 1984                          | 8,243,499              | 512,532,472              | 1.6  |
| 1985                          | 9,025,928              | 543,355,580              | 1.7  |
| 1986                          | 10,770,554             | 570,917,794              | 1.9  |
| 1987                          | 12,081,602             | 626,743,237              | 1.9  |
| 1988(b)                       | 12,760,770             | 572,173,091              | 2.2  |
| <b>% Increase, 1981-87(c)</b> | <b>193.3%</b>          | <b>72.3%</b>             |  |

- (a) 1988 data represents collections and accounts receivable as of November 30, 1988.
- (b) 1988 data represents collections and accounts receivable as of October 30, 1988.
- (c) Percentage increase calculated for complete calendar years only, from 1981 to 1987.



## APPENDIX B

### Implementation of Recommendations From Past Performance Audits

As part of this audit, we followed up on recommendations from two previous performances audits: Department of Revenue Division of Taxation (1982) and Improving Collections on Closed Sales Tax Accounts (1986). Using information provided by Department of Revenue officials, we prepared the following summary of the status of those recommendations as of January 1989.

| Accounts Receivable Management and<br>General Collection Considerations  | <u>Recommendation Implemented</u> |                  |           |
|--|-----------------------------------|------------------|-----------|
|  | <u>Yes</u>                        | <u>Partially</u> | <u>No</u> |
| 1982 Audit Recommendation: To aid identification of businesses required to remit sales and withholding taxes, the Department of Revenue and the Department of Human Resources should execute an interagency agreement whereby each agency makes its records available to the other.  | X                                 |                  |           |
| 1982 Audit Recommendation: The Department of Revenue should take the action necessary to ensure that interest rates for sales taxes in Kansas Administrative Regulations correspond to similar interest rates given in Kansas laws.  | X                                 |                  |           |
| 1982 Audit Recommendation: To ensure that the Department of Revenue applies all actions available to it in enforcing the State's tax laws, the Department should enforce administrative regulations in a more timely manner after such regulations are approved. To provide more timely and effective enforcement of the law, the Department of Revenue should reduce the time of referral of a case to the Legal Services Bureau and the issuance of a petition for injunction. To ensure that all actions available in enforcing the State's tax laws are applied, the Department of Revenue should initiate procedures in a more timely manner after legislation is passed. | X                                 |                  |           |
| 1982 Audit Recommendation: To ensure that handling costs are recouped for all businesses that fail to file returns on time, the Legislature should consider amending K.S.A. 79-3615 and K.S.A. 79-3228 to provide for a minimum penalty for businesses delinquent in filing sales and withholding taxes. This penalty would also be applied to delinquent returns that owe no tax.   |                                   |                  | X         |

Recommendation Implemented  
Yes                      Partially                      No

**Sales Tax Recommendations**

1982 Audit Recommendation: To comply with K.S.A. 79-3610 and K.A.R. 1981 Supp. 92-19-36, the Department of Revenue should improve its procedures to ensure that jeopardy assessments are made immediately when a taxpayer fails to file a return after notice from the Director and either terminates business operations or continues the act of making retail sales. To provide more incentive for taxpayers to file returns on a more timely basis, the Department of Revenue should consider holding taxpayers liable for the full amount of jeopardy assessments when such assessments are greater than the amount of actual returns filed.

X

1982 Audit Recommendation: To ensure that sales tax accounts are filed in a cost-effective manner and as required by law, the Department of Revenue should:

A. Periodically review retailers' sales tax accounts to ensure that accounts are placed on a payment cycle that coincides with K.S.A. 1981 Supp. 79-3607 and that maximizes revenue for the State. In implementing this recommendation, the Department should consider using its computer to:

1. Generate notices to retailers if their filing status has changed or if limits are exceeded for filing quarterly or annually.
2. Generate lists of status changes to Division personnel for updating accounts' filing status.

X

X

B. Identify and assess penalty and interest on those sales tax accounts not filing as frequently as required by law.

X

1982 Audit Recommendation: To ensure compliance with sales tax enforcement statutes and to help ensure equitable enforcement among all sales tax accounts, the Department of Revenue should:

A. Develop improved procedures for determining when sales tax registrations should be revoked. Among other points, the criteria should include for all taxpayers: the number of delinquencies, the dollar amounts owed in delinquent taxes, and

X

Recommendation Implemented  
Yes                      Partially                      No

the length of time the accounts have been delinquent.

- B. To ensure that revoked registrations are not reinstated until businesses fulfill necessary requirements for reinstatement. X

1986 Audit Recommendation: To maximize the collections made on both delinquent and closed sales tax accounts, the Department of Revenue should:

- A. Establish and follow standard procedures for more aggressive, consistent enforcement of the Retailers' Sales Tax Act against delinquent retailers. Such procedures could include seizing bonds before retailers go out of business, revoking registration certificates promptly, and seeking injunctions promptly. X
- B. Strengthen its bonding policies. All retailers should be required to secure and maintain bonds, bond amounts should be increased, and bonds should be seized to satisfy delinquencies before businesses close. X
- C. Systematically pursue enforcement of successor liability. State law currently requires the Department to hold purchasers of businesses liable for outstanding sales tax of sellers, up to the value of the property received. X
- D. Seek legislation authorizing the imposition of personal liability for delinquent sales tax on corporate officials. X
- E. Develop procedures for writing off closed sales tax accounts with insignificant balances. In many cases, it is not feasible or cost effective to collect these accounts, and writing them off would reduce the number of closed sales tax accounts managed by the Department. X

1986 Audit Recommendation: To minimize delinquencies and enhance the sales tax collections made after delinquent retailers go out of business, the Department should explore these options:

|   | <u>Recommendation Implemented</u> |                  |           |
|---|-----------------------------------|------------------|-----------|
|   | <u>Yes</u>                        | <u>Partially</u> | <u>No</u> |
| A. Developing procedures at the State level for identifying assets owned by delinquent retailers and providing county sheriffs with lists of those assets when warrants are filed.  |                                   | X                |           |
| B. Provide financial incentives to county officials for collecting on tax warrants. A penalty could be added to the warrant amount and earmarked for the locality.  |                                   | X                |           |
| C. Requiring purchasers to pay sales tax on large purchases directly to county treasurers or the Department of Revenue. State law currently requires sales tax on isolated purchases of motor vehicles to be paid in this manner. |                                   |                  | X         |

### **Bonding**

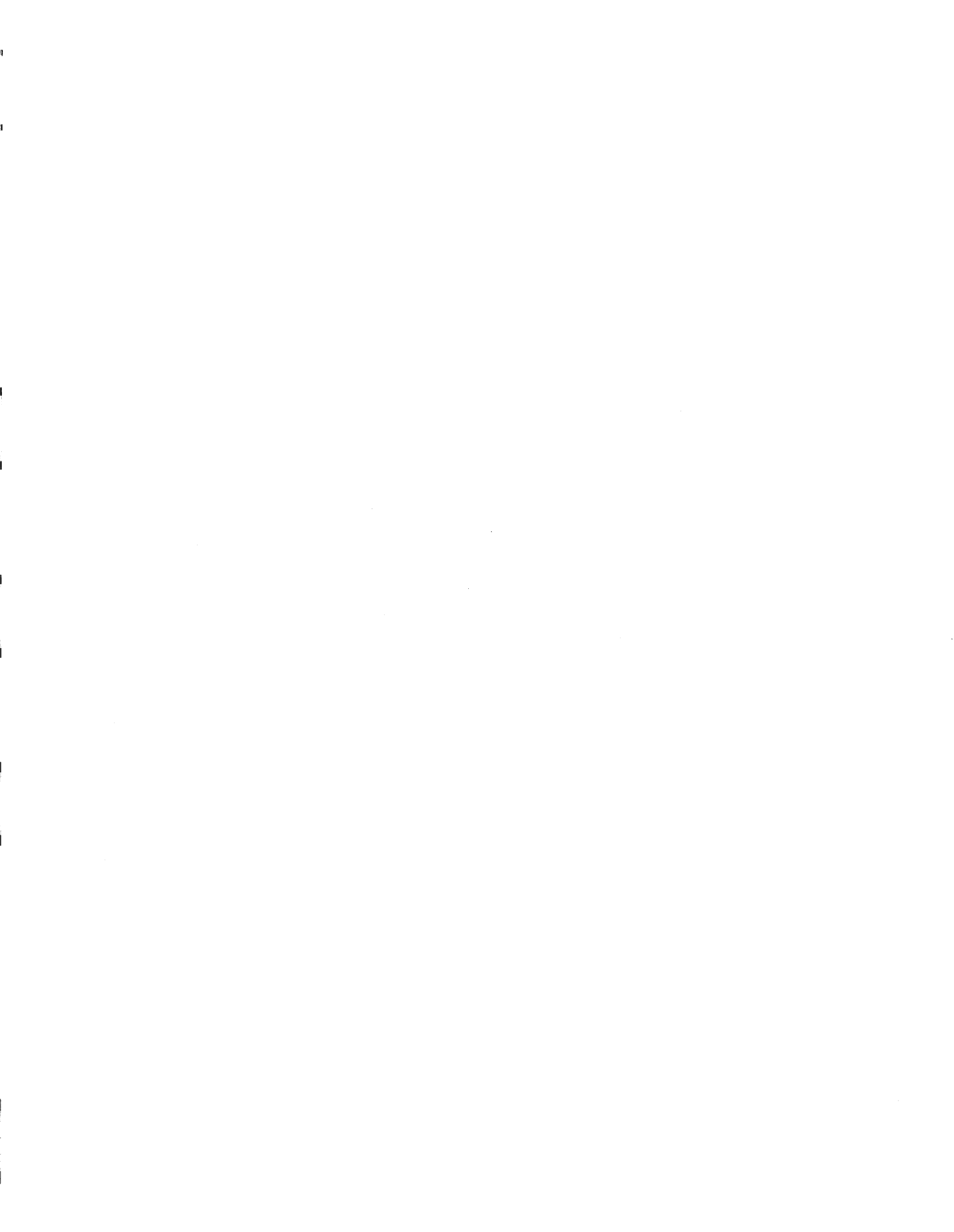
1982 Audit Recommendation: To help adequately protect the State from losses from unremitted sales and withholding taxes, the Department of Revenue's bonding policy should be strengthened through the following actions:

|  |  |   |   |
|--|--|---|---|
| A. The Legislature should consider amending State law to require all withholding taxpayers to post a bond at the time of registration.   |  |   | X |
| B. The Department of Revenue should take the following actions:  |  |   |   |
| 1. Amend State regulations to require all business remitting sales and withholding taxes to post bond at the time of registration equal to an estimated three months' liability, and to maintain that bond until a satisfactory payment record is established. |  |   | X |
| 2. Institute a policy that requires additional bonds for sales and withholding tax accounts that have become "high risk" accounts.   |  | X |   |
| 3. Periodically review accounts and update them to require additional bonds if the existing bond is found to be insufficient to meet the current average, as called for in State regulations.  |  |   | X |

## **APPENDIX C**

### **Agency Response**

On February 14, 1989, we sent a copy of the draft audit report to the Department of Revenue for review and comment. The Department's written response is included in this appendix.

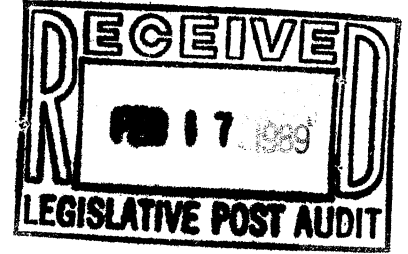




KANSAS DEPARTMENT OF REVENUE

Office of the Secretary  
Robert B. Docking State Office Building  
Topeka, Kansas 66612-1588

February 16, 1989



Meredith Williams  
Legislative Post Auditor  
Legislative Division of Post Audit  
109 West 9th, Suite 301  
Mills Building  
Topeka, Kansas 66612-1285

RE: Performance Audit Report, Department of Revenue's Delinquent Tax  
Collection Process

Dear Mr. Williams:

The Department of Revenue desires to respond to the work of the Legislative Post Auditors by thanking them for their good work. The audit has documented the accomplishments of the first year of the Division. The audit also serves as a tool to set goals for improvement.

The Department concurs with the audit that the creation of the Division has "streamlined" the Department's collection efforts. We feel that the policies of the Division create reachable goals in an automated environment. These policies which have been adopted provide a "fair but firm" collection approach. The Division anxiously awaits the implementation of the automated collection system, knowing that tools provided through that system will allow the Division the ability to address the concerns the auditors noted regarding the processing of accounts.

Recommendation A - page 6. Obtain or develop an improved accounts receivable system.

The Department of Revenue is currently reviewing the possibility of obtaining a new accounts receivable system. This system would be designed to work in concert with the automated collection system (currently in bid status) and the appropriate tax accounting and registration systems. This improved system would provide a great deal of information for reporting purposes and collections management, including an aging of delinquent accounts receivable.

Recommendation B - page 7. Develop new policies and procedures for writing off uncollectible accounts.

Any new accounts receivable system developed or acquired will include a write-off procedure as one of its administrative tools. The accounts receivable records are primarily maintained for management information. They are not part of the official records since the State's accounting system is not based on generally accepted accounting principles. Currently, the Department's systems do not support this function. However, we envision that a new in-house system as well as the proposed revision of CASK will support improved accounts receivable reporting.

Recommendation No. 1. Take collection actions within specified time frames.

Collection effectiveness is predicated on taking aggressive actions as promptly as possible. As other states, municipalities, and the I.R.S have demonstrated, the automated collection system is the best way to contact a large inventory of accounts with a limited number of collection personnel. Prior to its acquisition, we will further emphasize the importance of carrying out procedures within stringent time frames.

Recommendation No. 2. Identify accounts with collection priority.

Agreed. The automated collection system will be able to age accounts according to duration of each collection activity and will identify new delinquent accounts when accounts are transferred to the Division.

Recommendation No. 3. Submitting delinquent accounts for debtor set-off and utilizing a collection agency.

The Department is currently implementing procedures to refer individual income tax accounts to the Department of Administration for set-off. These procedures were adopted jointly in January, 1989. We plan to evaluate the success of these procedures before making any changes to current referral criteria. We also plan to introduce legislation during the current session which will permit referral of in-state accounts to a collection agency.

**Recommendations From Past Performance Audits**

Minimum penalties for delinquent filers of sales and withholding taxes.

This legislation was advanced but not enacted.

Jeopardy assessments should be made immediately when a taxpayer fails to file a return. Taxpayers should be held liable for the full amount of the jeopardy assessment.

To attempt to collect taxes that exceed the taxpayer's true liability, as evidenced by his return, would violate the Department's standard of fairness in tax administration. Penalties and interest, imposed in accordance with state law, are the proper incentives for prompt filing and payment.

Strengthening bonding policies.

Bonding is an issue which the Department and the Legislature have jointly addressed. The posture of the Legislature last session was to relax bond requirements.

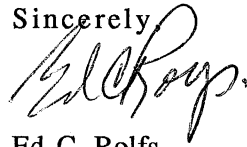
Develop procedures for writing off closed sales tax accounts with insignificant balances.

Please refer to Recommendation B - page 7.

Requiring purchasers to pay sales tax on large purchases directly to county treasurers or to the Department of Revenue.

State law places the responsibility of collection on retailers, not purchasers.

Sincerely,



Ed C. Rolfs,  
Secretary of Revenue

