Secretary of State Audit Report

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Strategies for Increasing Personal Income Tax Compliance and Revenue Collections

Summary

Oregon residents, and non-residents with earnings from an Oregon source, must file and pay personal income taxes when their income exceeds specified amounts. Oregon's Department of Revenue (DOR) estimates that for tax year 2006, the state received more than 81% of personal income taxes due.

Typical penalties for not filing and paying tax liabilities can range from 5% to 100% of the total unpaid liability plus interest. DOR addresses tax compliance through education and assistance, auditing and verification of filed returns, as well as filing enforcement and collection activities. More recently, DOR identified several best practice strategies for increasing tax filing compliance that DOR would like to pursue, such as:

- Requiring tax compliance of businesses and individuals who contract with the state or who receive state-issued licenses; and
- Implementing immediate technology upgrades to better manage accounts, beginning to expand the capacity of the DOR website to allow taxpayers to resolve issues online, and exploring other data management and analysis systems.

At DOR's request, we evaluated sources of information that would help identify non-filers. Specifically, we analyzed state professional licensing data, data from the Oregon Public Employees Retirement System, and Internal Revenue Service (IRS) data to identify the most productive strategies for DOR.

Using IRS data provided to DOR each year, we identified approximately 66,000 individuals who should have filed state income tax returns for tax year 2007, but had not as of the end of March 2009. We estimate these non-filers owed about $109 million in tax liability for tax year 2007. This represents an additional 2% of personal income tax liability. Based on past collection rates of non-filer debt, DOR would likely be able to collect about $54 million of the total liability over a five-year period.

In addition, our analysis of four state data sources — Public Employee Retirement System, Oregon State Real Estate Board, Construction Contractors Board, and Oregon Health Licensing Board — showed that 8,300 of the approximately 294,000 individuals included in our review should have filed state personal income taxes for tax year 2007, but had not done so by the end of March 2009.

Note: The background was amended since the release of the report.

See note that follows agency response for explanation of the strike-throughs.

We also evaluated DOR's practices related to non-filers and concluded that more could be done to develop a systematic, strategic approach to identify or take action with non-filers. DOR's current process for identifying non-filers is not comprehensive or data-intensive. While DOR's approach identifies some potential non-filers, it misses opportunities with available data sources to identify and prioritize many more potential non-filers.

We noted that state laws may not always create an adequate incentive to file if individuals do not owe taxes or owe very little. Current laws establish non-filing penalties that range from 5% to 100% of the amount of the tax liability and, depending on circumstances, additional penalties. As a result, these individuals face little or no penalty for not filing.

Another focus of our audit was DOR's collections practices. DOR has increased its emphasis on collections, ~~transferring about 30 positions from filing enforcement and~~ receiving approval for 15 more positions for the 2009-2011 biennium. While delinquent liabilities have fluctuated somewhat, overall they increased from $557 million in fiscal year (FY) 2005 to $621 million in FY 2009. DOR's internal collection rate has held fairly constant between 21 and 24%, though a lower rate occurs for collections efforts from non-filers.

DOR contracts with five private collection firms (PCFs) that are paid a commission based on tax revenue they collect. Overall, PCFs tend to collect less than 2% of the debt assigned to them. However, the debt they receive is much older than the debt DOR agents work. In addition, in most cases, PCFs receive accounts that DOR agents have worked for a year or more with no payment received for at least a year.

Collecting tax debt is challenging. Collectors must first locate individuals and determine whether they have assets that can be used to resolve the debt. Then, collectors use collection tools and persuasion to encourage or compel individuals to pay all or part of their tax debt. As discussed below, our review indicated that collections success is related to timely actions, up-to-date information about the delinquent taxpayer, good account management, and effective use of technology.

Timely Actions

Time is one of the most important factors in ensuring successful collections. The sooner an agency establishes contact with a delinquent taxpayer, the greater the chances of collecting on that liability. DOR's collection process does not ensure agents actively work new accounts and establish phone contact with the taxpayer in a timely manner. We found instances in which it took agents between 8 and 20 months from when they received a new liability until they called the taxpayer. Establishing a timely contact goal is one approach collections agencies use.

Taxpayer Research

The collection business relies heavily on research tools to locate up-to-date debtor information. Several companies have emerged in the industry that facilitate matching and sorting information to track down debtors who relocate or change employment or relationship status. DOR told us it has minimal research ability to collect up-to-date debtor information, but is interested in contracting with a private-sector company that offers such services.

Account Management

Collections managers need to routinely make decisions about how to allocate their staff resources based upon the specifics of the accounts they handle. A good account management approach not only ensures taxpayer contact occurs in a timely manner, but also that every action contributes to efficiently resolving the liability. This includes spending the optimal amount of effort on each account. We found accounts at DOR with considerable agent effort for years that had little or no payment activity.

In addition, DOR could better manage the accounts it sends to PCFs. We found that assigning accounts to PCFs can be labor intensive and some work is duplicated among units. When accounts are transferred between PCFs, the manual review process DOR uses can also be time consuming and sometimes is not performed in a timely manner. We noted some accounts spent 6 to 12 months in this review process.

The 66,000 non-filers we identified will significantly increase the DOR backlog of delinquent accounts. DOR could consider various strategies to expand collections capacity and accelerate collections. For example, depending on agents' case loads and success rates, DOR could choose to work all liabilities for a few months, or send some liabilities to PCFs without working them at all. Our conversations with PCFs indicate that DOR may be able to change its commission structure based on debt age. At least one PCF told us that because its agents are more effective when working newer debt, it would consider lowering its commission rate for newer liabilities. In addition, a lower commission rate would make it more cost-effective for DOR to delegate more work to PCFs to meet short-term demand and refocus its resources on other priorities.

Technology and Automation

Automated systems can assist in conducting research, contacting taxpayers, documenting taxpayer interactions, tracking collection steps and recommending future action. DOR has made some progress, but its current technology resources are cumbersome and limited.

Improvements are needed in the areas of reviewing accounts, moving them along the collection cycle and knowing when collection efforts should be outsourced. In addition, DOR's systems are not structured to readily provide management information, such as the average time between when the liability is established and first contact with debtor by phone, which can support decision-making. Other areas that could benefit from automation are the processes of reconciling PCF payments and providing account information, such as current balance, garnishment updates and other information that could help the collection process.

Recommendations

We recommend that DOR better identify and address the backlog of non-filers, increase tax compliance efforts, and increase the effectiveness and efficiency of its collections process. Detailed recommendations can be found on page 25 of the report.

Agency Response

The agency response is attached at the end of the report.

Background

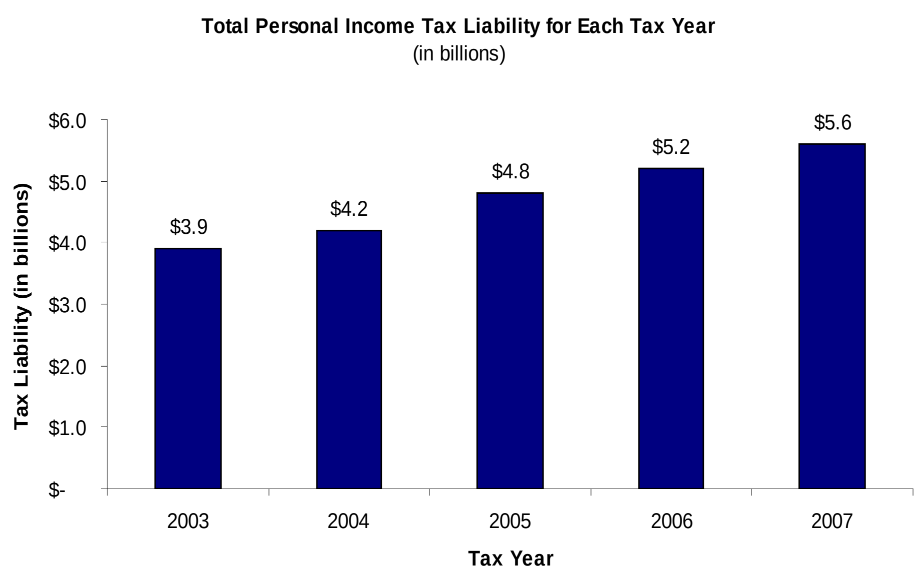
Introduction

A 2009 Department of Revenue (DOR) report to the Legislature noted a $1.2 billion gap between estimated and reported state personal income tax revenue for tax year 2006. DOR asked us to review several aspects related to personal income tax compliance. We focused our audit efforts on two main areas: 1) utilizing data resources to identify non-filers and increase compliance, and 2) reviewing collection practices for delinquent debt, especially as those practices relate to the use of private collection firms (PCFs).

DOR is responsible for enforcing tax laws and collecting a variety of taxes, some of which it transfers to various state and local agencies. Taxes collected include personal income tax, corporate tax, cigarette and tobacco tax, timber tax, and state lodging tax. According to the Legislative Fiscal Office, for the 2007-2009 biennium, DOR was authorized to employ 968 full time equivalent (FTE) staff and spend $186 million. DOR's 2009-2011 legislatively adopted budget authorized an additional 15 FTE for the collections and filing enforcement functions.

Personal income tax is the largest contributor to the General Fund. In the 2007-2009 biennium, it comprised 87 percent of General Fund receipts. For tax year (TY) 2007, taxpayers reported a total personal income tax liability of $5.6 billion. Personal income tax liability grew rapidly from 2003 to 2007, as shown in the graph below.

Graph1



In general, both Oregon residents and non-residents who earn income from an Oregon source are required to file and pay state personal income taxes in Oregon. Oregon residents are required to file and pay income taxes if they are required to file a federal income tax return, or if their gross income meets certain filing thresholds. For TY 2007, those thresholds ranged from about $5,000 to $12,000, depending on filing status. Non-residents and part-year residents are required to file if they have federal gross income from sources in Oregon that exceed the filing thresholds, which for tax year 2007 ranged from about $1,800 to $5,650 depending on filing status.

DOR estimates that for tax year 2006, the state received more than 81% of personal income taxes due. Many wage earners pay personal income taxes through withholding. Some exceed their tax liability and receive a refund when they file. Others need to pay additional money at the time they file. According to DOR, statutes require individuals to file if they meet the criteria above, even if they do not have a liability or expect a refund. DOR attempts to find individuals who do not file and pay, and bring them into compliance. The penalty for not filing and paying tax liabilities ranges from 5% to 100% of the total unpaid liability, along with additional penalties based on individual situations. In addition, DOR assesses interest on all liabilities.

Oregon's income tax system places the responsibility for complying with tax laws on the taxpayers because they have all the information needed to file an accurate return. However, some individuals engage in a variety of intentional behaviors to avoid paying taxes, while others face economic situations that affect their ability to pay the taxes they owe, or misinterpret the tax code.

DOR addresses compliance at three different stages:

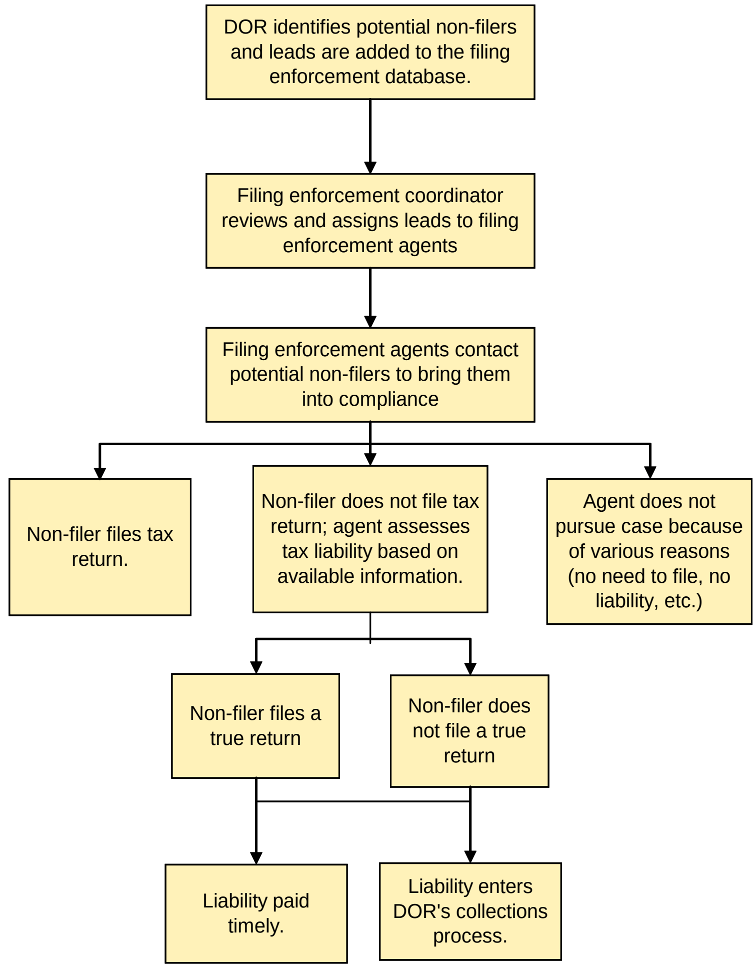
1) before a return is filed, through education and assistance;
2) after a return is filed, through audit and verification; and
3) when taxes are unpaid, through filing enforcement and collection activity.

The Personal Tax and Compliance Division carries out these duties. According to the Legislative Fiscal Office, the division had an adopted budget of $51 million and 363 FTE for the 2007-2009 biennium.

Filing Enforcement and Collections

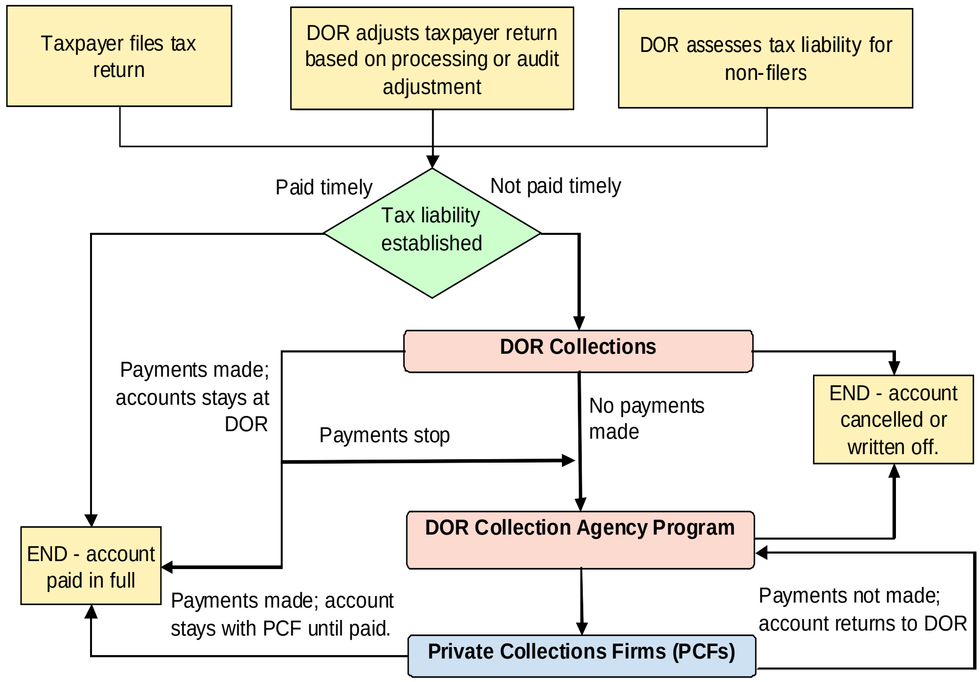
For taxpayers who are unwilling to voluntarily file personal income taxes, DOR employees attempt to bring them into compliance and sometimes even establish taxes due. For example, during fiscal year (FY) 2008, DOR contacted 14,600 individuals about 20,400 past due personal income tax returns, resulting in 6,600 returns filed by taxpayers because of those contacts and another 8,500 the department filed on behalf of individuals.

Figure 1: Filing Enforcement Work Flow Chart



DOR's collections efforts focus on encouraging payment of tax liabilities established by individuals when they file tax returns or by DOR personnel who make return adjustments or work with taxpayers who have not filed their taxes. DOR collects liabilities through the efforts of its own revenue agents. When agents are unsuccessful, DOR utilizes private collection firms (PCFs) for additional collection attempts. Accounts are typically assigned to up to three consecutive PCFs before being written off as uncollectible or cancelled.

Figure 2: The General Path of a Personal Income Tax Liability



As stated in its compliance report to the legislature, DOR believes that although personal income tax compliance exceeds 81%, it could do more to improve compliance and reduce the tax gap by adopting best practices, recommending legislative changes and adding resources. DOR identified several best practices to increase filing enforcement efforts, such as:

- Require applicants for state-issued licenses to show they have filed returns and paid their taxes before a license is issued or renewed.
- Collaborate with contract-issuing state agencies to develop an efficient way to establish tax compliance status before a contract is approved or paid
- Expand disclosure authority to Oregon licensing boards to notify those boards of a taxpayer's noncompliance (either non-filing or nonpayment) and ask for license suspension earlier in the filing enforcement or collections process.

In addition, DOR plans to make some immediate technology upgrades in the collections area. For example, it plans to incorporate an Automated Call Distributor (ACD) in early 2010. The system connects callers to a live agent even if their assigned agents are not available. DOR has also identified several long-term goals. According to the agency's compliance report to the Legislature, DOR future plans include the following:

- Upgrading collections case management and automated workflow tools, which will increase efficiency by assigning cases at the right time to the right collector.
- Developing a business intelligence platform that will improve business processes and automate data matching and analysis. With an enhanced intelligence tool, DOR can decide, within a certain degree of accuracy, how to assign accounts to maximize collection and minimize resources used for collection activity.
- Automating self-service options. Self-service initiatives would allow taxpayers to resolve their debts or conduct business without help from a department employee.

As part of its efforts to increase tax revenues, the Oregon Legislature directed the use of a tax amnesty program, which DOR implemented at the end of 2009. The program waived penalties and half of the interest due for tax liabilities that were not previously reported to or identified by DOR. Taxpayers had to file a request to exercise this option by November 19, 2009 and file new or amended returns by January 19, 2010. As of February 2010, DOR had deposited $33 million into a tax amnesty fund, a portion of which included personal income tax payments.

Audit Results

Using federal data available to DOR, we identified approximately 66,000 individuals who should have filed state income tax returns for tax year 2007, but had not as of the end of March 2009. We estimate these non-filers would have owed about $109 million in tax liability for tax year 2007. Based on past collection rates, DOR would likely collect about half this amount over a five-year period.

In addition, we reviewed DOR's collection practices, surveyed private collection firms with which DOR contracts, and researched collection best practices. Based on this work, we determined that DOR does not timely contact taxpayers by phone, does not have a strong performance management approach to collections and does not sufficiently use technology and automation to improve the efficiency and effectiveness of its collections efforts.

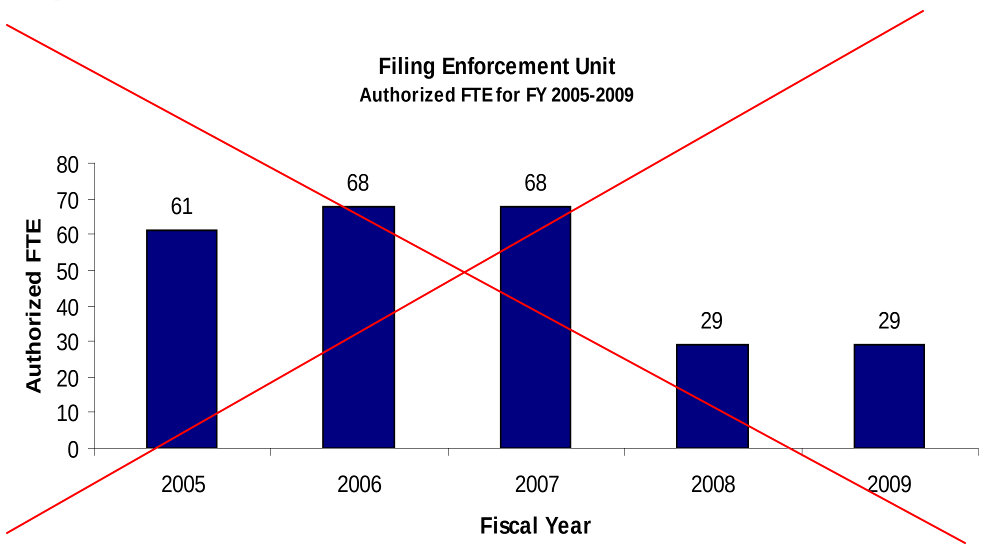
Filing Enforcement

Background

See note that follows agency response for explanation of the strike-throughs.

~~As shown in the graph below, in the last few years filing enforcement staffing decreased by more than half, as the department shifted resources to DOR's collection arm.~~

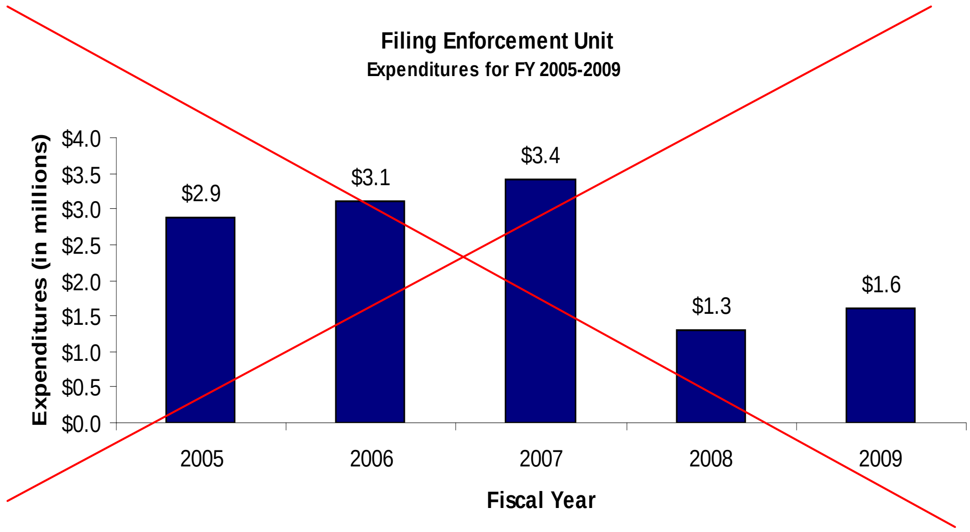
Graph 2



See note that follows agency response for explanation of the strike-throughs.

~~During FY 2009, expenditures for filing enforcement totaled $1.6 million and represented a decrease associated with the shift in personnel from filing enforcement to collections.~~

Graph 3



Introduction

We focused our audit efforts on evaluating sources of information that would help DOR identify non-filers. Our work revealed that the information DOR receives from the Internal Revenue Service (IRS) is a valuable source of information for identifying non-filers. Every year, the IRS provides DOR with information on individuals who filed federal personal income tax returns from an Oregon address, earned income in Oregon, or had income reported to an Oregon address. We analyzed the IRS information to identify non-filers and then applied additional procedures to distinguish the non-filers most likely to owe taxes.

Using IRS Data Would Identify Many Non-filers

We first combined and summarized about 33.5 million Oregon tax records and 26 million federal records to isolate tax year 2007 information. We then compared these two data sets and identified 223,000 individuals who filed a federal return from an Oregon address, or had more than $12,000 in gross taxable income earned in Oregon or reported to an Oregon address. None of these 223,000 individuals had filed an Oregon return by the end of March 2009. However, not all were residents. To simplify our analysis, we focused on full-year residents and excluded non-residents. In addition, to focus on individuals most likely to owe taxes, we also excluded all the individuals who had a reported adjusted gross income or taxable gross income of $25,000 or less. We also excluded non-filers DOR had already identified.

After taking these steps, we reduced our initial population of 223,000 individuals by 157,000 to 66,000. We conclude that the 66,000 individuals identified made at least $25,000 in gross income during 2007, did not file a state tax return for tax year 2007, and had a need to do so. We used DOR's past data on non-filer liabilities to estimate that these 66,000 individuals owe about $109 million in personal income taxes for tax year 2007, representing an additional 2% of tax liability for that year.

Our analysis of past non-filer and collection data shows that DOR is likely to collect about $54 million of the $109 million owed to the state over a five year period. However, for many of the individuals DOR brings into compliance for tax year 2007, it is likely to receive additional revenue in future tax years. In addition, it is likely that some of the 2007 non-filers failed to report tax liabilities for previous years. Therefore, DOR could also collect liabilities for tax years prior to 2007.

Department employees told us that the IRS files we used are loaded into the filing enforcement system, and that the system has the ability to generate a large-scale match between federal data and state filing data, similar to the initial analysis we performed that resulted in 223,000 potential non-filers. However, staff has not yet used this feature, and DOR would need to perform additional analysis to identify the exceptions of greatest interest.

Strategies Involving Boards and Commissions Identify Some Non-filers

As mentioned earlier, DOR believes it needs to do more to impact compliance and is working on several approaches to get more people to file and pay their personal income taxes. One approach DOR identified would be to require applicants for state-issued professional licenses to show they filed returns and paid their taxes before the licensing entities issue or renew their licenses. DOR obtained legislative approval and has started a pilot project to identify the potential compliance benefits of such a requirement.

We analyzed several sources of state information to determine whether they would be useful for increasing compliance with state personal income tax laws. Specifically, we determined the extent to which the following four groups of individuals complied with personal income tax requirements:

1. Members of the Oregon Public Employee Retirement System who receive retirement benefits or earn contributions;
2. Individuals licensed by the Oregon Construction Contractors Board;
3. Individuals licensed by the Oregon Real Estate Agency; and
4. Individuals licensed by the Oregon Health Licensing Agency.

In May 2009, we published an interim report of our analysis of licensing information from the Oregon Real Estate Agency.[1] We reported that about 9% of individuals licensed by the Oregon Real Estate Agency, or about

[1] Management letter no. 150-2009-05-01, "Revenue, Department of: Comparison of Data from the Oregon Real Estate Agency with Data Maintained by the Oregon Department of Revenue," May 19, 2009.

1,500 of 16,000 people, had not filed a 2007 state personal income tax return. Follow-up work on a sample of 40 individuals revealed that 68% should have filed a 2007 state return. Moreover, 45% of the individuals who failed to file in 2007 also failed to file in 2006, although they should have done so.

We used 278,000 records to identify whether individuals in the remaining three groups mentioned above who appeared to have a need to file actually did so. We identified 11,500 who did not file a 2007 state tax return as of the end of March 2009. Based on our follow-up work, we estimated 7,300 of the 11,500 individuals, or 64 percent, should have filed state personal income taxes for tax year 2007 and failed to do so.

As previously discussed, by using IRS data, we identified 66,000 non-filers. This is in contrast to the 8,300 (68% of the 1,500 individuals identified in the analysis of the Oregon Real Estate Agency plus the 7,300 individuals identified in the analysis of the other three groups) we identified by using the other four data sources. Furthermore, based on the results of our sample, we believe DOR could have identified the 8,300 non-filers by using the IRS information alone. Therefore, we believe DOR should set a higher priority on using its IRS information while pursuing various other methods to increase compliance.

DOR Lacks a Strategic Approach for Identifying Non-filers

DOR does not have a systematic, strategic approach to identify or take action with non-filers. DOR's current process for identifying non-filers is not comprehensive or data-intensive. According to DOR, examples of activities used to identify potential non-filers include matches with IRS audits and adjustments data, ad hoc queries on individual taxpayer filing history, and leads identified through other contacts with taxpayers. For example, in the process of collecting a liability from an "other agency account" (OAA)[2], a revenue agent notices an individual failed to file personal income tax returns for several years. The revenue agent would first ensure the individual meets Oregon personal income tax requirements and would then enter a lead into the filing enforcement database. Another example is a compliance specialist in the business division who, while auditing the payroll of a business, notices the owner and several employees have not filed personal income tax returns for years. In this case, the compliance specialist would send the business owner's information to DOR's Self Employed Filing Enforcement Coordinator and add wage-earning leads for the employees into the filing enforcement database.

Once filing enforcement employees identify these leads, they enter them into the filing enforcement system where they are kept for up to six years. The filing enforcement coordinator reviews the leads and assigns them to filing enforcement agents, who research each case and attempt to bring individuals into compliance with state income tax laws. The lead worker

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[2] Other Agency Accounts is a DOR section that collects liabilities on behalf of other state agencies and local governments.

tends to assign the oldest cases first in order to prevent them from being automatically removed from the system.

We were told there were roughly 22,000 filing enforcement leads in DOR's system, some of which were waiting to be assigned. These leads were generated over the last six years.

Some employees believed that there may not have been a need to generate more leads given that there has always been an abundance, and sometimes even a backlog, of leads to keep agents busy. However, lack of a systematic approach to identify leads may create less effective results.

Lack of Consequences for Some Non-filers

State laws provide penalties for failure to file personal income taxes, ranging from 5 to 100% of tax liability owed and, depending on circumstances, an additional penalty. However, the laws may not create an adequate incentive to file because individuals who do not owe taxes or owe very little will pay little or no penalty. Therefore, department employees abandon filing enforcement cases when the liability is very small, even though they have already done the work to establish a need to file.

While financial considerations are important when trying to maximize the use of a limited budget, consistently enforcing filing requirements to increase compliance is also a matter of equity among individuals with tax liabilities.

Delinquent Tax Collections

Background

As mentioned earlier, DOR collects delinquent liabilities with its own personnel, as well as with PCFs. As shown in the table below, while delinquent liabilities have fluctuated somewhat, overall they increased from $557 million in FY 2005 to $621 million in FY 2009. DOR's internal collection rate has held fairly constant between 21 and 24%. PCFs tend to collect less than 2% of the debt assigned to them. However, the debt they receive is much older than the debt DOR agents work. In addition, in most cases, PCFs receive accounts that DOR agents have worked for a year or more, sometimes with little or no result. Comparable data do not currently exist to evaluate the effectiveness of PCFs in collecting debt similar in age to DOR collections work.

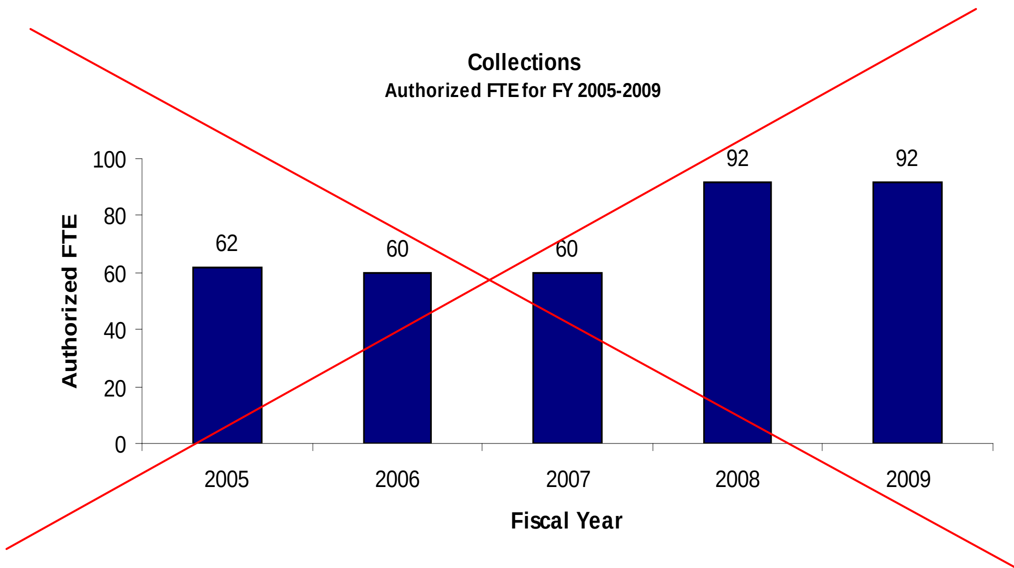
Table 1

Fiscal Year	Total Delinquent Liabilities	Liabilities Assigned to DOR	DOR Collections	DOR's Collection Rate	Liabilities Assigned to PCFs	PCF Collections	PCFs' Collection Rate
2005	$557,424,118	$431,888,209	$90,902,792	21%	$125,535,909	$2,221,599	1.77%
2006	$578,661,876	$431,512,578	$94,980,166	22%	$147,149,297	$2,834,538	1.93%
2007	$588,424,650	$437,425,312	$97,859,855	22%	$150,999,338	$2,915,231	1.93%
2008	$563,239,316	$445,396,117	$105,808,032	24%	$117,843,199	$2,442,715	2.07%
2009	$621,002,055	$474,927,082	$105,856,119	22%	$146,074,973	$1,879,855	1.29%

See note that follows agency response for explanation of the strike-throughs.

~~In the last five years, staffing levels have increased in the collections area, as shown in the graph below. As mentioned earlier, in the last two years, the collections unit benefited from an increase of staff reassigned from DOR's filing enforcement unit.~~

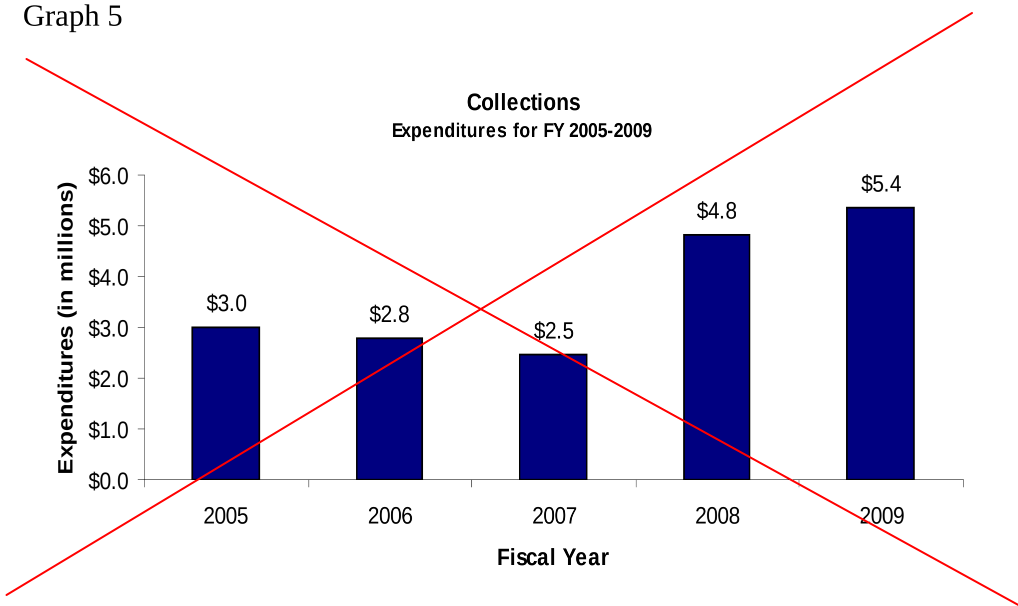
Graph 4



~~Collections expenditures have continued to increase over time. In the last five years, they almost doubled, according to department data, as shown in the graph below. These costs do not include expenditures associated with private collection firms' efforts.~~

See note that follows agency response for explanation of the strike-throughs.

Graph 5



DOR employs three types of revenue agents, each level representing greater experience, skill and responsibility. The Revenue Agent 1 (RA1) is the entry level agent who handles easier and more basic account types, such as those where the taxpayer is available and willing to pay. Revenue Agent 2, a new position created in 2009, has additional experience and enhanced abilities to handle more challenging accounts. Revenue Agent 3 works primarily in the field and handles the most challenging accounts, including taxpayers who are hard to locate or object to paying taxes. Accounts flow to the appropriate agent level based on a triage model implemented in 2009. The model matches account difficulty, based on taxpayer history, liability amount and availability of information, to agent skill and experience level to increase collection rates.

When DOR agents exhaust all collection methods available and do not receive a payment for one year, their accounts are forwarded to a PCF for additional collection attempts. There are some exceptions. For example, accounts will remain with DOR past the deadline of one year without payments if new liabilities are established, or if a payment is processed on any other liability for the same taxpayer account. In addition, some accounts are exempt from going to a private collection firm. For example, exemptions include accounts where the debtor is in bankruptcy, in prison, in school, on active military duty or is experiencing some kind of financial hardship.

DOR contracts with five PCFs, that are paid a commission based on tax revenue. Each PCF negotiates its own contract. During the course of our audit, PCFs charged DOR between 16 and 23% for general collection services. DOR's Collection Agency Program (CAP) manages DOR's relationship with PCFs. It employed six revenue agents and three administrative staff during FY2009, and expended $605,000 for operations. CAP employees receive accounts from Collections and Filing Enforcement

(CAFE) and assign them to PCFs, answer questions, reconcile payments, process garnishments, and communicate with taxpayers. When PCFs are not successful in their collection efforts and do not receive a payment for one year, they return accounts to CAP. An administrative specialist reviews these accounts for updated information and assigns them to a new PCF. Accounts are typically assigned to three different PCFs before being written off as uncollectible.

Collections Practices Success Factors

Collecting tax debt is challenging. Collectors must first locate individuals and determine whether they have assets that can be used to resolve the debt. Then, collectors must try to persuade or compel the individuals to pay all or part of the tax debt. Payments for tax debt can take many forms, such as direct payments, garnishments, applying a refund toward the debt, or seizing and selling property. Payment generally relies on two aspects: an individual's views toward taxes and the person's ability to pay.

Best practices suggest that the following are key factors for collections success:

- Timely actions
- Taxpayer research
- Account management
- Technology and automation

According to experts, and as noted in DOR's report to the Oregon Legislature, time is one of the most important factors in ensuring collections. The sooner an agency establishes contact with a delinquent taxpayer, the greater the chances of collecting on that liability. Timely personal contact is more likely to generate results if combined with active collection tools, such as following up on a letter with a phone call to the debtor. The PCFs we surveyed told us actively pursuing an account through personal contact, rather than just mail correspondence, increases the likelihood of collection. Many of these firms stated they try to have their agents spend as much time on the phone as possible. Furthermore, they build timely action into their collection practices by expecting phone contact on new accounts within a week of receiving them.

For timely taxpayer contact, agents need up-to-date contact information. Therefore, the collection business relies heavily on research tools to locate new debtor information. Several companies have emerged in the industry to facilitate matching and sorting information to track down debtors who relocate or who have employment or relationship status changes. In the collection business, this area is called "skiptracing." The PCFs we surveyed all utilize one or more skiptracing vendors that assist them in identifying taxpayer contact information for DOR liabilities. In addition to up-to-date contact information, skiptracing research helps collectors identify additional information that increases the likelihood of collections, such as assets, garnishment sources, and employment records.

Another very important success factor in the collection industry is having an account management approach to achieve the best results with available collections resources. Collections managers need to routinely make decisions about how to allocate their staff resources based on the specifics of the accounts they handle. A good account management approach not only ensures taxpayer contact occurs in a timely manner, but also that every action contributes to efficiently resolving the liability. This requires that agents spend the optimal amount of effort on each account.

To support their account management process and improve performance, collection entities need to identify what information is useful to track. For example, knowing the costs of each collection activity and identifying what collection activities generate the most revenue are important pieces of information that a collection organization must know in order to assess its operations. At a minimum, organizations should compare the costs and benefits of actions in order to choose among alternatives, a technique referred to as return-on-investment analysis.

Lastly, the collection industry depends heavily on the use of technology to support its operations. Automated systems can assist in conducting research, contacting taxpayers, documenting taxpayer interactions, tracking collection steps and recommending future action. Automated account management tools improve account management by allowing collections personnel to integrate information from various sources in order to build a debtor's picture, assess how much effort has been expended on an account and its stage in the collection process, and take specific action, such as sending automated mailings. For example, when collectors access accounts, it is helpful if they can see the person's tax history on the same screen. In addition, it is beneficial to have a system that sends letters automatically at certain points in the collection process, such as when a debt has just become delinquent. Automated phone systems dial multiple phone numbers at a time and leave automated messages for debtors who do not answer, thus reaching numerous people at the same time. These tools also route in-coming calls to the first available agent, minimizing wait time. Best practices recommend using such technology in order to increase the efficiency and success of operations.

Contact With Taxpayers Not Always Timely

DOR's collection process does not ensure agents actively work new accounts and establish phone contact with the taxpayer in a timely manner. Though data limitations prevented us from concluding on the frequency of delayed contact with taxpayers, we found instances in which it took agents between 8 and 20 months from when they received a new liability until they called the taxpayer. Delayed communication with taxpayers significantly decreases collection chances. DOR managers told us one contributing factor could be agents' large caseloads, between 1,600 and 2,500 cases per person. They also told us they believe the recent redesign of their account flow will help with the timeliness of taxpayer contact.

Establishing a timely contact goal is one approach used by collections agencies. For example, most PCFs with whom DOR contracts try to call taxpayers as early as possible after they receive new accounts. If they are able to locate a taxpayer phone number, most PCFs will call debtors within a week of receiving a liability. In addition, Other Agency Accounts, a DOR unit that collects delinquent liabilities on behalf of other state agencies and local governments, has a goal of working each liability within 30 days of receiving it.

A timeliness goal may also prove useful to not only ensure quick contact, but also a minimum level of effort on accounts before they are referred to a PCF. Department officials told us that in the past some liabilities were never touched by agents and, because no payments were received for 365 days, the accounts were referred to private collection efforts.

The ability to quickly contact taxpayers depends on a few critical factors. First, agents must have contact information for taxpayers. This is why so many collection businesses place great emphasis on research. DOR agents research individuals one at a time and don't have access to the skiptracing tools private agents do. While department agents have access to some state and public data sources, the PCFs we surveyed told us they contract with specialized companies for a variety of public and private databases and use various matching techniques to narrow down their searches. DOR told us it has minimal skiptracing ability, but is interested in contracting with a private-sector company that offers such services.

In addition, timely contact can be aided by superior phone technology. Modern communication systems dial a batch of numbers at the same time and make decisions based on the outcome of the calls. For example, if a debtor answers the phone, the system will immediately transfer the person to a collector. If the call reaches an answering machine, the system will leave a voice mail. Similar sophistication is possible for incoming calls. For example, systems can be programmed to respond to certain commands, and when prompted by a debtor, they will automatically route calls to the first available collections agent that meets predetermined screening criteria. Private collection agencies use such systems and, during the course of our audit work, we observed how these systems work in one of the PCFs with which DOR contracts. DOR, however, is behind in using these systems. During calendar 2010, it expects to debut an automatic call distribution system, but has no specific plans for updating its outgoing call capabilities.

Employ a Performance Management Approach With Accounts

According to best practices, organizations should review and streamline processes, collect appropriate information and analyze it to improve the results of their strategies as well as employees. While DOR is making progress in better matching collections accounts to agent skill level, more efforts are needed to ensure DOR employs an account management approach that promotes efficient and effective collection practices. In addition, DOR needs to identify key management information, and collect and analyze it in order to increase performance.

Currently, revenue agents have considerable discretion in the manner in which they manage their caseloads. Lead workers provide some training and guidance, but are not actively involved in managing each agent's work. Although this agent autonomy and account ownership can have benefits, we noted that agents may expend excessive time on accounts that do not have a great chance of generating payments. For instance, agents may give taxpayers multiple chances to pay without any resulting payments. They may also call multiple times, sometimes listen to lengthy explanations of why taxpayers cannot pay, and call back several more times with no result. Finally, they may conduct research to identify garnishment sources, go through a financial statement and establish multiple payment plans with individuals that continually break payment plan agreements.

We found liabilities that stayed with DOR for years, with considerable agent effort, that had little or no payment activity. In one case, DOR established a tax liability in 2003. DOR's agents worked this account for more than six years prior to assigning it to a PCF. As of the end of our fieldwork, agents had made a total of 22 calls and conducted much research before the account was transferred to a PCF. DOR was never able to establish a payment plan or receive any payment as a result of its efforts.

In another instance, a DOR agent set up seven payment plans over the course of 15 months. The taxpayer never made a payment during this period. DOR had the account for about six years, and during that period it made 16 phone calls and corresponded with the taxpayer in writing, requesting payment. DOR sent the account to a PCF in the spring of 2005 and took it back almost a year later. Since then, DOR has received some modest garnishment payments.

These examples may not be typical but with closer attention to account management and performance, DOR could have transferred the accounts much earlier to a PCF. As discussed earlier, the sooner a liability is acted on, the greater the likelihood of collection. While DOR did receive some revenue in the early stage of collections for some of the accounts mentioned above, in the last years of work, there were no direct payments, only tax refund offsets and withholding, which are exempt from PCF commission. Therefore, by transferring these liabilities earlier, DOR would have received the same amount of money and would not have invested the agent effort that did not produce results. Moreover, the DOR agents could have focused their attention on newer cases with a greater chance of collection.

One factor that contributed to the overworked accounts mentioned above is DOR's automatic clock, which moves unproductive accounts to a PCF if no payments are received within a year. However, the clock is reset each time a taxpayer has a new liability, among other factors. DOR may want to reconsider the number of ways the automatic clock can be reset. In the absence of active caseload management, resetting the clock with each new liability can lead to substantial effort being applied to accounts that do not generate payments.

DOR could also improve its results by better collecting and analyzing management information. For example, DOR does not currently develop information about debt characteristics, taxpayer filing history and change in filing characteristics, collection efforts, or results of collection approaches. Without these data, DOR does not know the costs and benefits of its collection efforts and lacks information to streamline its processes to increase efficiency, determine the optimal time to work accounts and educate revenue agents about being cost-conscious for each account. By collecting relevant information, DOR can set goals for actively working accounts and more closely manage agent queues to improve the collection process.

Better Coordinate Collections With PCFs

Along with more analysis of its own practices, DOR could better manage the accounts it sends to PCFs, and improve contract provisions it has established with them.

Currently, accounts are assigned to PCFs in two ways: through an automatic route or a manual one. The manual route appears to be labor intensive with some work duplicated among units. For example, an account moves from CAFE to CAP after DOR employees conclude they have exhausted all collection efforts available to them. An agent requests the transfer and a lead worker reviews the account before granting the approval. The review process includes several steps, such as checking the payment history, recent wages or available garnishment sources, as well as reviewing collection steps taken for final assurance that all collection efforts have been exhausted. If the lead worker transfers the account to CAP, an administrative specialist at CAP reviews the account to ensure it meets transfer criteria, meaning she or he will check much of the same details the CAFE lead worker verified before approving the transfer to CAP. If the CAP review determines that the account meets PCF transfer criteria, the account is then placed in a batch of accounts that automatically transfer to a PCF with the next monthly run.

CAP administrative specialists perform a similar review when accounts return from PCFs and are waiting to be assigned to a second PCF. The administrative specialist again looks for wages and garnishment sources and determines whether the account qualifies for write-off or cancellation. These steps occur before each placement with a new PCF. While DOR's policy assigns one account to up to three different collection agencies, we identified several accounts that were assigned to more than three PCFs. Department employees told us that more PCF assignments were justified because the liability amounts were very large. Regardless of how many PCFs an account goes to, the manual review process is time consuming and sometimes not performed timely. We noted some accounts spent 6-12 months in this review process. Given the time involved with each review, the number of assignments for each account and the delays in assigning accounts to a new PCF, the overall process likely costs the agency significant money in staff time and lost or delayed revenue. A well designed system would run through several automatic checks and make decisions based on the results of those searches. For example, the system could verify whether an account met write-off criteria. If the amount is small, the system could automatically approve the write-off. If the amount is larger, it may send it to a queue that needs manual review and approval. The system could also perform similar searches for wages and garnishment sources and make pre-determined decisions so employees can focus their manual reviews on a smaller number of accounts.

In addition, DOR has retained control of processing garnishments for accounts worked by PCFs. While DOR does reduce the commission it pays to PCFs when it processes garnishments, it has not studied the costs and benefits of handling garnishments for accounts it no longer actively works. PCFs are able to handle the garnishments from beginning to end, and it may be more efficient to delegate that responsibility to them, freeing DOR staff to focus on higher-value activities, such as contacting taxpayers with new liabilities sooner.

Another practice that deserves attention is DOR's decision to take accounts back from PCFs at taxpayers' request. PCFs noted that it is not uncommon for debtors to call the debt owners, in this case DOR, in an effort to bypass the collection agencies or to bring up customer service issues. According to PCFs, DOR's taxpayers appear to use this approach to circumvent the collection process because DOR sometimes settles for a smaller monthly payment than the PCF determined. This lowers revenues, delays the payoff date, and results in duplicated collection effort.

Another area for improvement is that of garnishment updates. Currently, DOR receives garnishment payments directly and does not provide up-to-date information on garnishments to PCFs. PCFs only receive a monthly report that shows whether they are earning a commission on the account that was garnished. If a PCF could be made aware immediately when a garnishment is stopped and no longer valid, the PCF could contact the debtor and restart the collection process. Given that timely action is such an important factor in the debt collection business, any delay could have an adverse effect on the ability to collect.

Expand Collections Capacity to Quickly Address the Backlog of Delinquent Accounts

If DOR pursues the 66,000 non-filers we identified, it will significantly increase the volume of work in filing enforcement. In addition, once a need to file and a tax liability is established, for taxpayers who do not pay their liabilities in a timely manner, the department will need to pursue collection efforts, which will add to the delinquent accounts collection agents already have. In order to give immediate attention to this matter and increase the chance of obtaining payments, DOR could utilize PCF capacity until the backlog of delinquent liabilities reaches a manageable level.

DOR already uses five PCFs to supplement its own efforts. DOR's Collection Agency Program (CAP) manages the relationship with PCFs, which operate under a statewide contract. In general, accounts that go to PCFs first spend at least one year in DOR's collection unit without receiving a payment. According to PCFs, many liabilities are several years old by the time they reach a PCF. The firms are compensated with a commission, which is a percentage of the tax revenue they collect. Each firm negotiates its own commission structure. Currently, commissions range from 16 to 23% for general collection service, and between 7 and 10% for payment generated through garnishments DOR processes at PCF request.

Increasing the use of PCFs in the collection process would require DOR to rethink its current model regarding debt age and commission structure. Depending on agents' case loads and success rates, DOR may choose to work all liabilities for a few months before sending them to PCFs, or they may choose to send some liabilities to PCFs without working them at all. Our conversations with PCFs indicate that DOR may be able to change its commission structure based on debt age. If PCFs typically receive debt that is at least one year old, under a new model, they could receive liabilities that are only a few months old, or those considered new liabilities. Several PCFs told us that because its agents are more effective when working newer debt, it would consider lowering its commission rate for newer liabilities. In addition, a lower commission rate would make it more cost-effective for DOR to delegate more work to PCFs to meet short-term demand and refocus its resources on other priorities.

Automation Could Produce Efficiencies

Another best practice for collecting debt is using technology to automate functions and thus increase efficiency. DOR has made some progress in this area, but opportunities for improvement still exist, especially in the area of reviewing accounts, moving them along the collection cycle and knowing when collection efforts should be outsourced.

DOR's current technology resources are cumbersome and limited. As mentioned earlier, DOR does not benefit from key modern research and telecommunication technology that would allow it to increase the efficiency of its operations. In addition, collection information is stored in three different systems which were designed to capture details for each account. Given how complex and different each taxpayer's situation is, the systems provide a lot of individual details but make it difficult to analyze information at the aggregate level. We attempted to perform such analysis during the course of our audit and were unable to do so because obtaining a comprehensive picture of a collection account required six different files. Some of the files had information that was not comparable because it sometimes referred to one liability and at other times referred to a taxpayer account, which contained multiple liabilities. Therefore, the data did not allow us to isolate the information pertinent to the specific liabilities we tried to analyze.

In its compliance report to the Oregon Legislature, DOR management noted much needed technology changes. These changes include obtaining a new system that would provide better account management, make training new revenue agents easier, and allow for greater accountability of the collection function. DOR has already received some funds for technological improvements and plans to request additional resources to implement changes. We encourage DOR to continue with its plans for improving its technological capabilities. Planning for and acquiring the right tools will take some time and, as we noted earlier in our report, time is an important factor in determining collections success. Some of the changes needed to improve automation may be achieved in the short-term using off-the-shelf products that can be adapted to DOR's needs or through improvements developed internally. As it plans to improve its use of technology, DOR should consider a short-term plan that will provide some timely and much-needed relief, along with long-range efforts that will offer a better platform for managing the entire process.

Other areas that could benefit from automation are the processes of reconciling PCF payments and providing account information, such as current balance, garnishment updates and other account information that may help the collection process. For example, reconciling PCF payments occurs manually at CAP. The unit receives a monthly report from each PCF, and an Administrative Specialist 1 (AS1) goes line by line and manually reconciles each payment. This process is very tedious and time consuming, as many of these reports are 20-50 pages. It takes multiple days each time, sometimes as much as several weeks each month for the AS1 to complete the reconciliation process.

In addition, significant effort is involved in providing PCFs with timely and accurate liability totals. Currently, PCFs do not have access to real-time account information, and most stated this is especially problematic when debtors want to pay the entire liability balance. In these cases, PCFs have to contact DOR directly to obtain accurate account balance information. They then attempt to contact the taxpayer to process a payment. Aside from being time-consuming, this practice increases the likelihood of a change occurring in the debtor's willingness or ability to pay, and may result in the loss of collections. Also, if payoff information PCFs use is inaccurate due to the lack of real-time account information, the PCF (and DOR) may be out of compliance with the Fair Debt Collection Practices Act (FDCPA), which states a debt collector may not use any false representation, such as the use of an inaccurate debt amount, in connection with the collection of the debt.[3]

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[3] FDCPA Section 807 (2)

Recommendations

To better identify non-filers and increase compliance, we recommend DOR:

- Develop and implement a comprehensive and timely approach to identify non-filers every tax period.

To increase the effectiveness and efficiency of collections, we recommend DOR apply performance management strategies, including:

- Establish and track timeliness and results goals for DOR personnel to better achieve prompt contacts and successful collection of each liability.
- Periodically analyze information on agency strategies, efforts and results to enhance collections results.
- Transfer liabilities to PCFs based upon case characteristics to obtain the most DOR revenues.
- Pursue skiptracing alternatives and integrate the use of advanced research tools into the DOR collection process.
- Automate the processes of assigning accounts to PCFs, reconciling payments and providing account balance updates.
- Explore ways to increase sharing information with PCFs to enhance collections.
- Prudently plan, acquire and implement a comprehensive information technology system that will support automating processes, prioritizing work and managing performance.

In order to accelerate tax compliance efforts and address the backlog of non-filers, we recommend DOR:

- Develop and implement strategies to bring non-filers quickly into compliance for future tax years.
- Develop and implement a plan to quickly increase collections, which could include more outsourcing efforts, until the backlog is reduced.

Objectives, Scope and Methodology

The purposes of our audit were to evaluate data sources to identify non-filers and increase compliance, to review collection practices for delinquent debt, and to make recommendations meant to improve compliance with personal income tax laws.

A) To address our first audit objective and evaluate data sources to identify non-filers and increase compliance, we talked to DOR management and staff about filing enforcement activities, and we reviewed documents pertaining to filing enforcement. We obtained information from four state entities about individuals who were licensed to do business in Oregon, worked in Oregon in a public service capacity or received retirement benefits from the public service institution associated with the Oregon Public Employee Retirement System for tax year 2007. More specifically, we obtained records from the following entities:

1) Members of the Oregon Public Employee Retirement System receiving retirement benefits or earning contributions;
2) Individuals licensed by the Oregon Construction Contractors Board;
3) Individuals licensed by the Oregon Real Estate Agency[4]; and
4) Individuals licensed by the Oregon Health Licensing Agency.

We conducted reasonable tests for the above data sources and found the data was sufficiently reliable for audit purposes.

Based on our audit results obtained from analyzing the state data sources mentioned above, we decided to expand our audit objective and determine the usefulness of using federal tax data that DOR receives from the Internal Revenue Service. More specifically, we used federal data on individuals who filed a federal income tax return from an Oregon address for tax year 2007 or who earned income in Oregon or income sent to an Oregon address.

We did not assess the reliability of the federal data because we did not have access to source records. However, we did perform general tests of reasonableness and eliminated sections of data that appeared to not be relevant to our analysis or pertained to individuals who did not need to file in Oregon. Since the federal information is the same information that DOR employees use in their non-filer enforcement work, we determined the data was reasonably reliable for the audit team to use for identifying non-filers.

In addition to the data sources mentioned above, we also used state tax information for tax year 2007, such as tax return data, information on quarterly estimated payments, and data from DOR's filing enforcement database. The Audits Division had recently reviewed this information, except for filing enforcement data, in relation to the annual audit of the

[4] See management letter no. 150-2009-05-01, "Revenue, Department of: Comparison of Data from the Oregon Real Estate Agency with Data Maintained by the Oregon Department of Revenue," May 19, 2009

State's Comprehensive Annual Financial Report and had determined that the data was sufficiently complete and accurate to be used for audit purposes. We relied on the work performed for the previous audit and did not conduct additional data reliability for these data. We did not assess the reliability of the filing enforcement data.

In order to determine a need to file, the audit team referred to Oregon Revised Statues, Chapter 316 and DOR's tax filing instructions for tax year 2007.

In order to assess the usefulness of the state data sources we initially selected, we compared the list of data sources mentioned above with the list of individuals who filed a tax year 2007 state return, extension or quarterly estimated payment on tax year 2007 liabilities. We then selected a random sample from each data set and accessed federal filing information and wage data reported to the IRS to determine who had a need to file, but did not do so for tax year 2007. The population, sample sizes and results are shown in the table below:

Table 2

		PERS Benefits	PERS Contributions	Construction Contractors	Health Licensing	*Totals Without Real Estate Board*	Real Estate Agency	*Grand Totals*
POPULATION Details	Population of individuals in analysis	72,570	176,308	5,873	23,467	*278,218*	15,936	*294,154*
	Tax return not in DOR's system	**2,405**	**5,022**	**824**	**3,222**	***11,473***	**1,488**	***12,961***
	Percent not in DOR's system	**3.3%**	**2.8%**	**14.0%**	**13.7%**	***4.1%***	**9.3%**	***4.4%***
SAMPLE Details	Sample no. of indivduals	44	42	40	48	*174*	40	*214*
	Individuals who did not file TY 2007 tax return	**35**	**36**	**14**	**12**	***97***	**27**	***124***
	Percent who did not file in TY 2007	**79.5%**	**85.7%**	**35.0%**	**25.0%**	***55.75%***	**67.5%**	***57.94%***
	Individuals who did not file TY 2007 & 2006 tax return	18	22	8	1	*49*	18	*67*
	Pecent who did not file for TY 2007&2006	40.9%	52.4%	20.0%	2.1%	*28.2%*	45.0%	*31.3%*

In order to assess the usefulness of federal records, we created and compared two data sets, one containing state tax information and one containing federal data. First, we combined and summarized about 33.5 million state tax records to isolate tax year 2007 information on tax returns, tax extensions, quarterly estimated payments and other payments made for tax year 2007. Then, we combined 26 million federal records containing federal filing data and income reported to the IRS for tax year 2007. We summarized each of these files by social security number and compared federal filing and income data to state filing and payment data to determine those individuals who did not file or make a payment, but appeared to have had a need to do so.

This analysis identified about 223,000 individuals who had an IRS record for tax year 2007 because they filed a federal return from an Oregon address, and/or had more than $11,995 in gross income taxable in Oregon, which was earned in Oregon or reported to an Oregon address. The $11,995 gross income filing threshold corresponded to a full-year resident married couple at least 65 years old who filed jointly. We used this threshold for our audit for a more conservative analysis.

None of the 223,000 individuals we identified filed an Oregon tax return by the end of March 2009, the time we obtained the data for our analysis. However, not everyone has a need to file a state return depending on residency, and some would have had a small liability. To better estimate liabilities, we excluded all the individuals who had a reported adjusted gross income or taxable gross income of less than $25,000. We believe this approach, which reduced our gross population of 223,000 individuals by 126,000 people, would increase the likelihood that the remaining individuals had an actual tax liability.

In order to account for the complexity of the residency factor, we randomly selected a sample of 42 individuals who had income reported to the IRS from multiple addresses, at least one of which was Oregon. We then used voter registration information from the Secretary of State Election Division and drivers license data from the Oregon Department of Transportation to determine whether these individuals were Oregon residents during tax year 2007.

Our research revealed that 17 percent of the individuals in our sample were not residents and 45 percent were residents. In addition, we could not conclusively establish residency for 38 percent of the sample. In order to be conservative, we applied only the 45 percent verified residency rate to the section of our population where residency was not clear, and excluded the non-residents and the inconclusive ones from further analysis. As a result, we eliminated a total of 23,000 individuals from the 223,000 individuals originally identified.

Further, we removed individuals with non-filer leads in the department's filing enforcement system. Although some individuals may not have been actively pursued at the time, the department was aware of their existence and could open cases to further investigate their compliance. This excluded about 6,000 additional individuals from our analysis.

Based on all these adjustments, we believe at least 66,000 individuals of the 223,000 initially identified did not file a state tax return for tax year 2007 and had a need to do so.

We then used the department’s historic data related to filing enforcement to estimate the corresponding tax liability. Calculating tax liability for non-filers is a complicated process, because there is little known about these 66,000 individuals we identified. While we know certain taxable income elements, we do not know all their income. Furthermore, we do not have information on their filing status, dependents, credits and deductions that factor into the liability determination. Our goal in developing this number was to show the order of magnitude regarding missed tax revenue if no changes are made to the department's current process for identifying non-filers.

According to DOR's fiscal year 2008 filing enforcement statistics, 32 percent of the non-filers filed a return when they were contacted by the department. Another 42 percent did not respond and the department had to estimate liabilities and file returns based upon known income. Among that group about 26 percent were abandoned for several reasons, such as individuals had excess withholding, did not have a need to file or could not be located.

We applied these fiscal year 2008 statistics to our adjusted population of 66,000 individuals and calculated the percent of individuals we expected to file on their own, be assessed a liability or not be contacted based on preliminary department research. For the individuals on whose behalf the department had to file a tax return and assess a liability, we used the department fiscal year 2008 average liability of about $1,600. For the individuals who filed on their own, we used the statistics the department reported for tax year 2007 because the department does not track, and therefore could not provide, historical data on the individuals who filed a return after the department contacted them. The tax year 2007 statistics showed that 88 percent of individuals were full-year residents, while 12 percent were part-year or non-residents required to file. They also showed that the full-year residents had an average tax liability of $3,200, and the part-year or non-residents had an average liability of about $1,900.

Based on DOR's collection data for filing enforcement efforts, we expect the department will collect about $54 million of the $109 within five years of assessing those liabilities. We discussed methods for estimating tax liability with DOR's research department and the Legislative Fiscal Office.

B) To answer our second audit objective, reviewing collection practices for delinquent debt, we spoke with agency personnel involved in collecting delinquent debt at various levels, including those in the Other Agency Account unit, and we surveyed the private collection firms with which DOR contracts. We also referred to Oregon Revised Statues, Chapter 293, 305 and 314, Oregon Administrative Rules Chapter 150, as well as the Fair Debt Collection Practices Act and the statewide contract under which private collection firms operate.

In addition, we researched collection best practices, we reviewed other states' collection efforts and audit reports on the topic, and we gained an understanding of DOR's recent collection process changes and planned changes.

To identify whether DOR's collections practices are efficient, we attempted to track all delinquent liabilities established in calendar year 2003 through to the present, determine how many were paid in full and assess the level of effort expended in the process. We obtained a download from DOR of all the collections liabilities established in 2003, and several additional files that would help us conduct our analysis. After numerous attempts to conduct our analysis, we concluded that the data were not conducive to a large scale analysis.

We then modified the scope of our analysis and judgmentally selected a sample of 10 liabilities. We obtained and analyzed additional information on these liabilities, such as all liabilities for the taxpayer and all payments for the account, including payments for all associated liabilities.

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

Oregon
Theodore R. Kulongoski, Governor

Department of Revenue
955 Center St NE
Salem OR 97301-2555

April 8, 2010

Hon. Kate Brown, Secretary of State
900 State Street, Room 136
Salem OR 97301

Re: Response to Audit Report: Strategies for Increasing Personal Income Tax Compliance and Revenue Collections

Dear Secretary Brown,

This letter is the Department of Revenue's response to the audit report on income tax compliance. We greatly appreciate the work of your staff from the Division of Audits, and for their collaborative effort to improve the collections and filing enforcement functions at the Department of Revenue. This audit is an outstanding example of a partnership between two agencies striving to improve the effectiveness of state government.

The Department of Revenue agrees with your key findings. We can continue to develop better methods for identifying people who do not file Oregon personal income tax returns. We also agree that our collection function can be enhanced by further developing our performance management strategies.

Filing Enforcement

The department restructured the Personal Tax and Compliance division (PTAC) in February 2010. One of the keys to the restructure was to create a renewed focus on the Filing Enforcement Program. As you noted in the audit report, we had shifted a significant number of positions from filing enforcement to collection activity. This was to be able to respond to a request from the legislature for faster revenue generation as the economic downturn started. Since that time, we have re-evaluated the role of filing enforcement in our compliance strategy and concluded that it is time to restore those positions, which we will do once we have satisfied our revenue commitment to the legislature.

We restructured our PTAC division to pursue a strategy of maximizing voluntary compliance. Identifying non-filers and getting them into compliance is a key outcome of that strategy. We have functionally aligned all filing enforcement staff, and assigned a program manager to this area. As you recognized in the audit report, in addition to developing systematic approaches to identify greater numbers of non-filers each year, we also must change our business processes to effectively manage the resulting increase in the volume of work. We will continue to improve our filing enforcement processes by incorporating the use of process improvement tools beginning in the second half of 2010. We have identified three high level outcomes for filing enforcement:

- Number of non-filers identified.
- Number of non-filers acted upon/number of non-filers identified.
- Tax liability voluntarily reported and paid by former non-filers.

We expect to see significant changes in the results of our filing enforcement processes by June 30, 2011.

Collection Processes

In July 2009, we reengineered the collection work flow process to the extent we could within the current limitations and potential cost benefit of modifying our existing automated collection system. As noted above, PTAC restructured the collections function in February 2010 to streamline and align the personal income tax collection function. We have begun detailed mapping of our current processes and expect to benefit from using process improvement tools, such as Lean process improvement techniques, to further improve the collection function. We are also reviewing our use of private collection firms in order to get the greatest benefit from the services they provide. In recognition of the importance of timely contact with taxpayers, we implemented an Automated Call Distributor (ACD) system in March 2010 to improve collection efficiency and gain operational information.

Please convey my thanks to all of your staff who contributed to this audit for their recommendations and their professionalism.

Elizabeth Harchenko

Elizabeth Harchenko, Director
Oregon Department of Revenue

Our mission at the Oregon Department of Revenue is to make revenue systems work to fund the public services that preserve and enhance the quality of life for all citizens. Our vision is to become a model of 21st century tax administration through the strength of our people, technology, innovation and service.

Note: FTE and Expenditures

Subsequent to the release of the audit report, DOR management informed us that the background information on FTE and expenditures they provided was inaccurate. Moreover, they were not confident that they could provide data for the five-year period we analyzed due to various system limitations and organizational changes.

According to DOR management, most of the shift in resources shown by the data originally provided by the department was due to administrative restructuring and not due to actual changes in work activities. While management reported that there was a slight increase in emphasis on collections, readers are advised that the graphs shown on pages 10, 11, 15, and 16 overstate the shift in emphasis.

DOR management also advised us that the FTE counts they provided inadvertently omitted staff located in field offices.

These changes to information in the background section of the audit do not affect our findings or recommendations.

About the Secretary of State Audits Division

The Oregon Constitution provides that the Secretary of State shall be, by virtue of her office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of the Executive, Legislative, and Judicial branches of Oregon government. The division audits all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

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The courtesies and cooperation extended by officials and employees of the Oregon Department of Revenue during the course of this audit were commendable and sincerely appreciated.