



**New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor**

**Department of the Treasury
Division of Taxation
Tax Debt Collection**

July 1, 2015 to September 30, 2017

**Stephen M. Eells
State Auditor**



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Enclosed is our report on the audit of the Department of the Treasury, Division of Taxation, Tax Debt Collection for the period of July 1, 2015 to September 30, 2017. If you would like a personal briefing, please call me at (609) 847-3470.

A handwritten signature in black ink, appearing to read "Stephen M. Eells".

Stephen M. Eells
State Auditor
February 21, 2018

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Scope

We have completed an audit of the Department of the Treasury, Division of Taxation (division), Tax Debt Collection for the period July 1, 2015 to September 30, 2017. Our audit included financial activities accounted for in the state's General Fund and Property Tax Relief Fund. Our audit was focused on the portion of the contract the division entered into with an outside vendor to provide tax debt collection assistance.

The prime responsibilities of the division are to administer the state's tax laws uniformly, equitably, and efficiently to maximize state revenues to support public services, and to ensure that voluntary compliance within the taxing statutes is achieved without being an impediment to economic growth. Tax debt collection involves the collection of deficient and delinquent taxes from businesses and individuals. Deficient taxes represent the underpayment of taxes and delinquent taxes represent the failure of taxpayers to file tax returns.

Objectives

The objectives of our audit were to determine whether financial transactions were related to the division's programs, were reasonable, and were recorded properly in the accounting systems. Another objective was to determine the effectiveness of the division's tax debt collection efforts with its contracted collection agency. Our final objective was to determine the adequacy of logical access controls for the Taxation Unremitted Liability Inventory Plotting System (TULIPS), and contingency planning of the collection agency.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In preparation for our testing, we studied legislation, the administrative code, circulars promulgated by the Department of the Treasury, the terms of the contract with the collection agency, and policies of the division and the collection agency. Provisions we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our testing of financial transactions. We also reviewed financial trends and interviewed agency personnel to obtain an understanding of the programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions on our audit objectives as well as internal controls and compliance. Sample populations were sorted and transactions were judgmentally and randomly selected for testing.

Conclusions

We found that the financial transactions included in our testing were related to the division's programs, were reasonable, and were recorded properly in the accounting systems. While we found that the collection agency was achieving the guaranteed minimum revenue amounts per the contract, we noted weaknesses related to the billing process, unassigned cases, and terminated employees which present opportunities for revenue enhancement. We also noted the collection agency's caseworkers were not transferring cases within the appropriate stages of the collection cycle in a timely manner, and supporting documentation was missing from case files. In addition, we found that logical access controls over TULIPS were adequate, except that any caseworker can transfer a case to the uncollectible status without supervisory approval. We further noted a disaster recovery plan has been developed by the collection agency in accordance with the contract.

We also observed the contracted contingency rate decreases as the amount of tax debt collections increase, thereby reducing the incentive to obtain year-end collections.

Background

The division entered into an agreement with Pioneer Credit Recovery, Inc. (collection agency) to perform administration, resolution, and collection of deficient and delinquent taxes. The most recent contract term spanned from July 1, 2012 through June 30, 2017. The contract is currently in its first of two additional one-year extension periods. The collection agency is compensated based on a percentage (contingency rate) of the amount of collections it obtains for the division. The contingency rate was 10.6 percent of revenue eligible collections in fiscal year 2016. Revenue eligible for compensation is defined as all revenue assigned to collection agency caseworkers and all revenue collected within 10 days after the case is transferred from a collection agency caseworker back to the division. Revenue eligible compensation for the collection agency in fiscal year 2016 was \$112.5 million. Pursuant to New Jersey Administrative Code 18:2-2.5, the division charges the debtor a fee for an amount equal to the contingency percentage in the contract.

The contract includes annual guaranteed minimum revenue amounts that the collection agency must achieve or else be required to pay to the state the difference between the minimum and actual revenue amounts. The contracted guaranteed minimum revenue amounts include revenue eligible for compensation along with several types of revenue not eligible for compensation, such as monies received for unassigned collection agency cases and monies received for federal and state set-offs. The contracted guaranteed minimum revenue for the collection agency in

fiscal year 2016 was \$115 million compared to the calculated revenue amount of \$184.2 million.

The division has three units monitoring the collection agency. The Contract Liaisons Unit provides on-site oversight and assistance in managing problem situations, providing guidance on division policies and procedures, and determining the validity of arbitrary assessments made by the division. The Contract Management Unit reviews the collection agency's monthly bill to the state. The Deferred Payment Control Unit oversees the handling of taxpayer payment plans.

Unassigned Cases and Set-offs

The collection agency has a significant amount of unassigned cases.

Individual and business deficient tax debt collection cases that meet the minimum liability amount are automatically transferred to the collection agency's backlog within the division's case tracking system (TULIPS) approximately 90 days after they are created in TULIPS or billed by the division to the taxpayer. The minimum liability amount assigned to the collection agency is \$100, except for Corporate Business Tax which is \$250. Delinquent cases are transferred to the collection agency approximately 45 days after they are created in TULIPS.

Unassigned Cases

The collection agency employs approximately 150 caseworkers for tax debt collection. It was assigned 452,000 total cases as of June 22, 2017. Of these, 427,000 were not assigned to collection agency caseworkers. When a case is unassigned, there is no communication with the taxpayer regarding their outstanding tax liability. The aging of unassigned cases by last activity date as of June 22, 2017 was as follows.

| Days Since Case's Last Activity | Number of Cases |
|---------------------------------|-----------------|
| 0 – 30 | 7,389 |
| 31 – 60 | 6,783 |
| 61 – 90 | 22,067 |
| 91 – 120 | 3,377 |
| 121 – 365 | 89,691 |
| 366 – 730 | 112,567 |
| 731 – 1,460 | 60,509 |
| 1,461 – 2,920 | 97,946 |
| 2,921+ | 26,801 |
| Total | 427,130 |

Although the collection agency is meeting its minimum revenue requirement per the contract, the caseload is too voluminous for the number of personnel employed. As a result, many cases are not being worked on in a timeframe that would enhance collections. Working on tax debt collection cases in a timely manner is pivotal for the division to collect revenue for prior tax debts.

Set-offs

Pursuant to N.J.S.A. 54:49-19 and the Department of the Treasury Circular 16-09-OMB/TAX, the division is required to “set-off” the tax debt of contracted vendors providing services to the state. The circular states that the division may begin the set-off process 90 days after issuing the state vendor a “Notice and Demand for Payment” (demand letter) for any state tax owed. A set-off reduces the payment to the contract vendor by the amount of the vendor’s state tax indebtedness.

Usually, deficient cases are eligible for set-off. We compared and analyzed fiscal year 2016 state contract vendors to those that had open collection agency deficient tax debt cases prior to July 1, 2016. The analysis disclosed 48 state contract vendors having deficient tax debt cases but receiving payments from the state for services. Of these, 37 vendors had “unassigned cases.” Since demand letters are not distributed to vendors when cases are unassigned, the set-off process cannot be initiated by the division. The state could have received up to \$135,000 in possible set-offs for these unassigned cases.

Our analysis also disclosed 667 non-contract state vendors having deficient tax debt cases prior to July 1, 2016 but they received payments from the state for services in fiscal year 2016. Possible set-offs for these vendors totaled \$1.1 million. We judgmentally selected 15 vendors and noted 14 could have been set-off if the division was able to use the same criteria as state contract vendors. Of the 14 vendors, 12 had cases that were unassigned with no demand letters mailed to the vendor. The other two vendors had cases that were assigned and appropriately mailed demand letters, but set-off letters were not sent to the debtor.

Recommendation

We recommend the division evaluate the caseload that is appropriate for the collection agency to handle at a particular time. We also recommend the division consider entering into additional contracts with vendors to work on the burdensome backlog of unassigned cases. In addition, we recommend the division perform a match of tax debt cases to current state contract vendors and prioritize those cases for assignment. We further recommend the division consider seeking statutory changes to include non-contract state vendors as being eligible for possible set-offs.



Uncollectible Case Oversight

The division should strengthen controls over the transferring of tax debt cases to the uncollectible status.

A division policy defines uncollectible cases as those where the division “has made all reasonable efforts to collect money owed to it and generally if the debt is older than 10 years.” Additional factors the division utilizes to terminate active collection on a case includes the division not being able to locate the debtor and when the cost of collection on a case is anticipated to exceed the amount recoverable. All uncollectible cases for the division are within the same uncollectible status in TULIPS. Division policy requires caseworkers to record their notes in the Taxpayer Registration (TaxReg) system and to detail the reason the case was transferred to the uncollectible status.

There were 214,942 cases in the division’s uncollectible status as of May 25, 2017. Collection agency or division employees transferred 446 cases from the collection status to the uncollectible status from July 1, 2015 through May 25, 2017. We judgmentally selected 25 uncollectible cases for testing and noted seven cases, totaling approximately \$90,000, were moved to the uncollectible status incorrectly. In addition, 20 of the 25 cases did not have notes recorded in the TaxReg system by the caseworker to support the transfer to the uncollectible status.

We also noted that any caseworker can transfer a tax debt collection case to the uncollectible status without supervisory approval. The division does not have an employee specifically assigned to review the uncollectible status and the movement of cases. As a result, there are no compensating controls over the process of transferring cases as uncollectible. This allows cases to be classified as uncollectible in error and could result in the division losing tax revenue.

Recommendation

We recommend the division review existing uncollectible cases and assign personnel to oversee the transferring of cases to the uncollectible status.



Separated Employees

The collection agency should re-assign all cases from separated employees.

As of June 22, 2017, the collection agency had approximately 25,000 cases assigned to caseworkers. Of these, 4,900 (20 percent) totaling \$2 million were assigned to separated collection agency employees as far back as 2006. It is the responsibility of collection agency management to reassign cases after an employee is separated. Most of the 4,900 cases (99 percent) were in a pending status. We sampled the top ten dollar amount cases and an additional

50 randomly selected cases. The results indicated that five cases ranging from \$1,300 to \$46,000 should have been reassigned to collection agency employees as they were placed in the pending status in error or information was never received. An additional two cases were subsequently reassigned to the division's Set-off of Individual Liability unit for having a liability under \$1,000 after we notified the division. Most of the remaining cases (77 percent) tested require payment corrections in order for the cases to be closed.

In addition to those in pending status, there were 34 cases totaling approximately \$236,000 in the assigned status that were assigned to separated employees. Included in this amount were cases with a liability amount of \$111,600 assigned in 2008, and a liability amount of \$67,900 assigned in 2012. By reassigning cases to current employees, the collection agency will increase collections, close cases when appropriate, and provide a more accurate snapshot of its caseload.

Recommendation

We recommend the division oversee the collection agency's reassigning of cases to current employees immediately upon the separation of former employees. We also recommend that cases should be closed when appropriate.



Vendor Collection Report

The billing process between the division and the collection agency should be improved.

Monthly billing is initiated by the division instead of the collection agency. The billing process originates with the division's system generated Vendor Collections Report (VCR) which details monthly revenue recorded in cases assigned to the collection agency. The division has a Contract Management Unit (CMU) whose primary purpose is to review this report. The CMU analyzes the VCR to determine if the report includes items that are inaccurately deemed revenue eligible or ineligible to the collection agency, such as manual adjustments in the system and overpayments. The collection agency also reviews the VCR for any considerations it believes should be included as revenue eligible. The CMU makes a final determination on those considerations. The collection agency then provides the division with a bill totaling the final VCR amount.

The CMU consists of a supervising investigator and five staff investigators. Based on our inquiry, division management estimated that the CMU investigators spend 400 hours each month (nearly half of their time) reviewing and adjusting the VCR. We performed a cost-benefit analysis of fiscal year 2016 activity by allocating CMU investigators' hours spent on the VCR and calculating their salary and fringe benefit costs. We compared this result to the change from the initial system generated VCR to the final VCR generated by the CMU. We found the investigators' salary and benefits costs totaled \$246,000, while the final adjusted bills

actually increased by \$251,000. Therefore the benefit to the state of utilizing CMU investigators to review the VCR does not appear to outweigh the cost.

The CMU investigators could be more effectively utilized by performing casework and assisting in the division's collection efforts for deficient and delinquent taxes. Division management estimates that each investigator performing casework would collect an additional \$750,000 to \$1 million annually. By utilizing these estimates, we calculate division collections would be enhanced by at least \$3 million.

Recommendation

We recommend that investigators within in the CMU be utilized for field investigations to enhance revenues for the division. Monthly billing can be based on the VCR and additional system generated information.



Tax Debt Collection Process

The division should strengthen its monitoring over the collection agency's tax debt collection process.

Cases proceed through various collection stages depending on the results of the tax debt collection process. The initial stage is referred to as the contact stage in which letters are sent to the taxpayer detailing the state taxes owed along with information about the collection agency. This stage continues for 30 calendar days and is followed by the demand stage in which a demand letter is mailed to the taxpayer. The demand stage continues for 30 and 90 days for individuals and businesses, respectively. If tax collection efforts are unsuccessful, the case will move into the Certificate of Demand (COD) stage. As described by the division, a COD is a judgment of record entered with the Superior Court of New Jersey for the purpose of placing a lien against the real and/or personal property of the debtor. The COD stage continues for 15 calendar days and cases may then be assigned back to the division. The collection agency also has a Deferred Payment Control group which handles internal and external payment plans with taxpayers. Internal payment plans are negotiated between the collection agency and the taxpayer and external payment plans are negotiated between the division and the taxpayer. The division periodically audits collection agency caseworkers to determine if cases are being moved through the tax debt collection process efficiently.

We randomly sampled 34 cases assigned to collection agency caseworkers as of May 15, 2017. Of these, 24 started with the collection agency at the contact stage. We noted 18 of the 24 cases were not in the contact, demand, or COD stage within the appropriate timeframe. A COD was not filed for four of those cases even though they met the proper criteria. In addition, we noted

14 of the 34 case folders did not include all proper supporting documentation, such as copies of payments and demand letters.

Recommendation

We recommend the division perform more frequent audits of the collection agency's caseworkers to determine if they are moving cases through the process's various stages efficiently.



Observation

State Contract

The division entered into its most recent tax debt collection contract with its collection agency in fiscal year 2013. The contract term is for five fiscal years with the option of extending the contract up to an additional two fiscal years. The Request for Proposal (RFP) included a "Price Schedule for Administration of Deficient and Delinquent Tax Accounts." Potential bidders were required to provide contingency rates for the six collection ranges. Based on the collection agency's bid, contingency percentages fluctuate as the amount of collections increase. Contingency percentages for fiscal 2017, along with any contract extension period, are as follows.

| Collections | Contingency Percentage |
|-------------------------------|-------------------------------|
| \$0 - \$50,000,000 | 10.7 |
| \$50,000,001 - \$100,000,000 | 10.7 |
| \$101,000,001 - \$150,000,000 | 10.7 |
| \$150,000,001 - \$200,000,000 | 9.6 |
| \$200,000,001 - \$250,000,000 | 4.5 |
| \$250,000,000 + | 5.0 |

For future contracts, the division should consider structuring the RFP so that the contingency percentage for tax debt collections increases as more debt is collected. This direct relationship between debt collected and contingency paid could incentivize the collection agency to collect more debt before the end of the contract year because the compensation rates would reset to

lower levels at the beginning of the next year. The current structure might have a negative effect and encourage the collection agency to postpone year-end collections until the new year begins and the compensation rates are at their highest.





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February 14, 2018

John J. Termyna, Assistant State Auditor
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125 South Warren Street, PO Box 067
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Re: Department of the Treasury, Division of Taxation, Tax Debt Collection

Dear Mr. Termyna,

We appreciate the opportunity to respond to the audit findings and recommendations for the Department of the Treasury, Division of Taxation, Tax Debt Collection for the period July 1, 2015 to September 30, 2017. The following is in response to the recommendations contained in the audit report.

Unassigned Cases and Set-offs

Recommendation: We recommend the division evaluate the caseload that is appropriate for the collection agency to handle at a particular time. We also recommend the division consider entering into additional contracts with vendors to work on the burdensome backlog of unassigned cases. In addition, we recommend the division perform a match of tax debt cases to current state contract vendors and prioritize those cases for assignment. We further recommend the division consider seeking statutory changes to include non-contract state vendors as being eligible for possible set-offs.

Response: The Division of Taxation has implemented an improved taxpayer billing process for deficient tax accounts and has lowered the deficiency amount threshold for taxpayers requesting a Deferred Payment Plan as a part of an on-going effort to resolve cases earlier in the collection process, thereby reducing the number of cases assigned to the collection vendor. Through the use of improved analytics, we are also in the process of reprioritizing existing cases assigned to the collection vendor based on various factors including the amount of the deficiency and the potential collectability to provide for more efficient and effective case assignment.

We will explore the feasibility of utilizing the existing vendor contract or pursuing other vendor contracts to reduce the backlog of lower priority cases.

The Division of Taxation is working with the Office of Management and Budget to identify state contract vendors with existing tax debt earlier in the collection process in order to expedite case assignment, if necessary. We will also discuss with OMB potential statutory changes for non-contract state vendors.

Uncollectible Case Oversight

Recommendation: We recommend the division review existing uncollectible cases and assign personnel to oversee the transferring of cases to the uncollectible status.

Response: The Division of Taxation has generated lists of cases that may have been transferred to uncollectible status in error. These lists are in the process of being reviewed and any necessary corrective action will be taken. We have also established guidelines requiring supervisory approval prior to a case being transferred to an uncollectible status.

Separated Employees

Recommendation: We recommend the division oversee the collection agency's reassigning of cases to current employees immediately upon the separation of former employees. We also recommend that cases should be closed when appropriate.

Response: The Division of Taxation has and will continue to generate lists of employees that have separated from the collection vendor for review by the Contract Liaison Unit to ensure all cases are reassigned by the collection vendor and/or closed, as appropriate.

Vendor Collection Report

Recommendation: We recommend that investigators within the CMU be utilized for field investigations to enhance revenues for the division. Monthly billing can be based on the VCR and additional system generated information.

Response: The Division of Taxation is developing a streamlined vendor billing process that is expected to reduce the number of hours required per month for the review and approval of the vendor collection report from 400 to approximately 50 hours per month allowing Contract Management Unit investigators to be reassigned to other collection related functions.

Tax Debt Collection Process

Recommendation: We recommend the division perform more frequent audits of the collection agency's caseworkers to determine if they are moving cases through the process's various stages efficiently.

Response: The Division of Taxation is in the process of developing management reports to identify cases that are beyond standard timeframes at any point in the collection process in order for any necessary corrective action to be taken and ensure all cases are properly moving through the collection process.

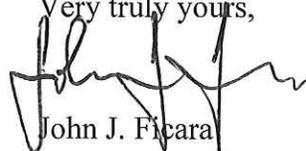
Observation – State Contract

The Division of Taxation will consider all pricing options for future Tax Debt Collection contracts to ensure the best interests of the State of New Jersey are met. The Division's current oversight practices will not allow the postponement of month-to-month collections.

It should be noted that the Division of Taxation has issued an RFP for a new modernized Integrated Tax System (ITS) to replace its existing legacy tax systems that were developed in the 1980's. Once implemented, the ITS will provide the case management tools necessary to more effectively address many of the recommendations contained in the audit report. In the interim, the Division is continuing to evaluate processes and seek internal solutions that provide for better use of staff and resources, increased productivity and overall efficiency.

We thank you for your input and appreciate the professionalism that your staff brought to the engagement.

Very truly yours,

A handwritten signature in black ink, appearing to read 'John J. Ficara', written over the typed name.

John J. Ficara
Acting Director
Division of Taxation

cc: Acting State Treasurer, Elizabeth Maher Muoio