

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION
COLLECTION OF DELINQUENT TAXES**

**PERFORMANCE AUDIT REPORT
JULY 2013**

To The Fiscal Committee Of The General Court:

We conducted a performance audit of the collection of delinquent taxes by the Department of Revenue Administration (DRA) to address the recommendation made to you by the joint Legislative Performance Audit and Oversight Committee. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions. The evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The purpose of the audit was to determine if the DRA's Division of Collections efficiently and effectively collected delinquent taxes during State fiscal years 2011 and 2012.

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

July 2013

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ABBREVIATIONS

CO	Compliance Officer
Division	Division Of Collections
DRA	Department Of Revenue Administration
DoIT	Department Of Information Technology
I&D	Interest And Dividends
IT	Information Technology
LBA	Office Of Legislative Budget Assistant
M&R	Meals And Rentals
RSA	Revised Statutes Annotated
SFY	State Fiscal Year
TAM	Technical Assistance Manual
TIMS	Taxpayer Information Management System

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EXECUTIVE SUMMARY

In both State fiscal years (SFY) 2011 and 2012, the Department of Revenue Administration (DRA) collected approximately \$1.2 billion in taxes. The amount of outstanding delinquent taxes which the DRA's Division of Collections (Division) was responsible to collect was approximately \$29 million as of June 30, 2012.

The Division experienced significant changes to its operations and staffing levels since SFY 2010. From SFY 2010 to 2012, staffing levels were reduced from 16 filled staff positions to eight, and the average amount of tax collected per Compliance Officer (CO) increased from \$560,000 in SFY 2009 to \$1.3 million in SFY 2012, an increase of 132 percent. In response to the staffing reductions and a desire to be more efficient, the DRA changed how it prioritizes taxpayer contact methods based on the amount and type of tax owed the State. Under a new Division Director, the primary contact method for most COs changed from traveling around the State making face-to-face contact with taxpayers to making contact by telephone and mail. The Director also started tracking basic monthly collection data to allow for better oversight of Division performance.

However, we found weaknesses in internal controls over its delinquent tax collection process and supporting computer systems, which increases the risks of 1) inefficient and ineffective operations, 2) inconsistent treatment of taxpayers, 3) the loss of collectable taxes, and 4) inaccurate data. We also found the Division was not effectively enforcing taxpayer compliance with statutory requirements to pay delinquent taxes with uniform application of statutes and rules. The Division did not consistently:

- receive or process delinquent tax notices timely,
- file liens to secure assets for the nonpayment of taxes,
- obtain proof of taxpayers' inability to pay,
- inform the public on payment options and requirements, and
- retain all documentation related to collection cases.

The Division lacked administrative rules for methods it uses in collecting delinquent taxes, such as payment arrangements, liens, abatements, and settlement agreements. The Division also lacked authoritative internal policies, as its *Technical Assistance Manual* was strictly used as guidance for COs instead of being requirements for employees to follow and subsequently be measured against. Without rules to provide employees and taxpayers requirements, the employees and public were not fully informed on the how the Division was supposed to collect delinquent taxes and how a taxpayer could respond.

DRA officials and employees we interviewed had concerns with the quality of the data being entered into Department computer systems. We found weaknesses in controls over Department computer systems which increased the risk of inaccurate data. We also found the DRA did not take adequate steps to identify, analyze, and mitigate external and internal risks to its operations.

While demonstrating greater efficiency in its operations during the audit period, particularly as its employees and budgets decreased significantly, the Division's effectiveness was negatively affected by weaknesses in its internal controls. The DRA should improve its policies and procedures and adopt administrative rules to help ensure the equitable treatment of taxpayers and the collection of delinquent taxes at the least cost to the State.

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RECOMMENDATION SUMMARY

Observation Number	Page	Legislative Action Required?	Recommendation	Agency Response
1	13	No	Refine the abatement authority delegation to include authority to abate fees; define the “best interest of the State” when applied to abatements; clarify “waive” in the abatement delegation; monitor the Director’s abatement decisions to ensure compliance with his delegated authority; delete monthly reporting requirements from the abatement delegation if technological advancement has made separate reporting redundant; and require the Division fully document reasons for abatement transactions.	Concur
2	16	No	Promulgate administrative rules for payment agreements in order to provide clear requirements for both the DRA and taxpayers. Specifically address how taxpayers must document their inability to pay and ensure the Division obtains and maintains written payment agreements.	Concur
3	17	No	Adopt administrative rules for its use of liens as a collection tool and ensure they are consistently applied.	Concur
4	18	No	Develop, issue, and adhere to an authoritative policy and procedure manual to codify Division policies and procedures to help ensure compliance with statute and consistent collection practices.	Concur
5	20	No	Promulgate, implement, and oversee a statutorily compliant records management program for the Division.	Concur

Observation Number	Page	Legislative Action Required?	Recommendation	Agency Response
6	21	No	Strengthen the IT control environment by establishing system development controls, creating and testing operational disaster recovery and business continuity plans, improving physical access controls to DRA’s building, increasing controls over user access privileges to information technology applications, and creating and implementing a user account management policy and procedure.	Concur In Part
7	25	No	Improve risk management controls by establishing written policies and procedures for business processes; conducting and documenting biannual risk assessments; increasing oversight over third-party service providers; regularly completing internal audits; creating and implementing a quality control system to ensure data are accurate; and designating an employee to identify, evaluate, and manage business operations and IT systems risks.	Concur In Part
8	29	No	<p>Expedite assignment of collections cases to the Division; assess the efficiency of the tax notice practice, and promulgate administrative rules to formalize the practice if it is to remain in effect; consider reducing the 80-day pre-programmed assignment of non-Meals and Rentals (M&R) tax notices to the Division; determine and remedy the cause for other delays in assigning tax notices to the Division; and ensure the Division timely processes cases.</p> <p>Expedite assignment of M&R collections cases; determine and remedy the cause for delays in assigning M&R tax notices to the Division; expand efforts to measure Division and Compliance Officer performance; and gather case data to measure the timeliness of collection actions and case outcomes.</p>	Concur

Observation Number	Page	Legislative Action Required?	Recommendation	Agency Response
9	31	No	Promulgate administrative rules and policy regulating the use of settlement agreements and offers-in-compromise before continuing their use. Formalize procedures to operationalize DRA administrative rules and policy.	Concur In Part
10	32	No	Provide sufficient guidance on its website explaining the circumstances by which taxpayers can seek payment agreements and abatements.	Concur
11	34	No	Identify employee training needs and develop an appropriate training program for Division employees. Include appropriate funding for this training in biennial budget requests.	Concur
12	35	No	Consider expanding use of the <i>Remarks</i> section of <i>TIMS</i> to improve interdivisional communication and ensure employees from the Collections and Audit Divisions have greater access to each other's case notes.	Concur
13	36	No	Discontinue the practice of requiring delinquent meals and rentals operators provide bank account security information until such time as the DRA has authority to do so in statute.	Concur

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BACKGROUND

The Department of Revenue Administration (DRA) administers most of the State's taxes and assists municipalities in their administration of other taxes. The DRA's mission is to collect the proper amount of taxes due at the least cost, while maintaining a high degree of public confidence. The DRA collected approximately \$1.2 billion in taxes in both State fiscal years (SFY) 2011 and 2012, while decreasing its expenditures from \$16 to \$13 million, respectively. Staffing at the Department decreased from 167 employees in June of 2011 to 121 in June of 2012, a 28 percent decrease. At the end of SFY 2012, the DRA's Division of Collections (Division) had a caseload of outstanding taxes, interest, penalties, and fees worth about \$29 million according to unaudited DRA data. This represents less than three percent of the \$1.2 billion the DRA collected during the year.

The Division Of Collections

RSA 21-J:8 establishes the Division of Collections under the supervision of an unclassified Director who is responsible for:

- collecting all outstanding taxes owed to the State, which are within the Department's jurisdiction; and
- securing all delinquent returns required to be filed with the State by any taxpayer.

The Division's mission includes fairly enforcing taxpayer compliance with statutory requirements to pay taxes, collect overdue returns and tax payments with uniform application of statutes and rules, and to conduct its business in a professional manner. The Division is provided the powers of a tax collector under State law. The Division can:

- impose liens (i.e., legal claims to the taxpayer's property for the amount of the debt),
- make payment arrangements,
- seize (i.e., distrain) the assets of a person or a business who has not paid taxes,
- suspend or revoke meals and rentals operator licenses, and
- offset tax refunds from other DRA-administered taxes.

The Division also has the ability to abate taxes, penalties, and interest owed by taxpayers. During SFYs 2011 and 2012, the Division reportedly approved 6,208 abatement transactions totaling \$3 million. (One tax notice could have multiple abatement transactions, i.e., taxes, penalties, and interest could each be abated.)

The DRA contracted with private debt collectors to collect on out-of-state cases when the Division exhausted all other options available to it. In June of 2012, the out-of-state debt collector had 1,093 tax notices representing an outstanding balance of \$7.8 million. During SFY 2012, the out-of-state debt collector was able to collect about \$130,000 in outstanding debt. Appendix B presents collection practices utilized by the Division, in addition to a listing of debt

collection strategies identified from a May 2010 survey of 21 states conducted by the National Association of State Auditors, Comptrollers, and Treasurers and CGI, an information technology and business services firm.

Division Staffing

In addition to the unclassified Director, the Division employed two Clerks IV, one Compliance Officer (CO) I, and five COs II for a total of eight filled classified positions. This was half as many employees as the Division reportedly had in 2009. Table 1 presents the number of positions available to the Division and those actually filled.

Table 1

**Division Of Collections Staffing
SFYs 2011 And 2012**

Title	2011		2012	
	Authorized Positions	Filled Positions	Authorized Positions	Filled Positions
Director	1	1	1	1
Assistant Director	1	1	0	0
CO II	10	10 down to 8	6	5
CO I	2	2	2	2 down to 1
Clerk IV	2	2	1	2 down to 1
Total	16	16 down to 14	10	10 down to 8

Source: DRA, Division of Collections.

The Division’s appropriations and expenditures are presented in Table 2, showing the Division spent 34 percent less in 2012 than in the previous fiscal year, related to the decrease in staffing.

Table 2

**Division Of Collections
Appropriations And Expenditures
SFYs 2011 And 2012**

SFY	Appropriation	Expenditure
2011	\$1,128,000	\$1,008,000
2012	\$ 791,000	\$ 667,000

Source: NH First, Statements of Appropriations.

Table 3 shows collections revenue by the Division for the past four years. The average amount collected per CO increased from about \$560,000 in SFY 2009 to \$1,300,000 in SFY 2012, primarily as a result of the loss of seven CO positions.

Table 3

**Division Of Collections
Revenue From Collection Activities
SFYs 2009 Through 2012**

SFY	Revenue
2009	\$ 7,297,944
2010	10,543,933
2011	11,242,989
2012	7,804,198

Source: Unaudited Division of Collections data.

Tax Notices

If the DRA finds taxes are owed or additional tax penalties and interest are due, a tax notice is issued to the taxpayer and the Division starts its collection process. Tax notices can be assigned to the Division differently, depending on the type of tax.

- The meals and rentals (M&R) tax is a trust tax, meaning a business collects this tax for the State and must deposit monthly with the DRA all taxes collected. If the monthly payment is not made, the Division sends a reminder letter about 15 days after taxes were due, and issues a tax notice 10 days later.
- Other DRA units generate, or the DRA's *Tax Information Management System* (TIMS) automatically issues, a tax notice for nonpayment of taxes for non-M&R taxes (e.g., business enterprise and business profits, real estate, and interest and dividends). The taxpayer has 60 days to appeal or pay the notice before it is assigned to the Division.

Tax notices above certain thresholds are assigned to a CO to initiate either telephone or mail contact, depending on the value of the notice. Tax notices are tracked in TIMS and the Manual Accounts Receivable System, but individual COs have their own methods for tracking and managing their caseloads.

During the audit period, the Division reengineered some of its work processes, including increasing reliance on telephonic contact with taxpayers and reducing the number of COs in the field. The Division also refocused its collections efforts on business taxes, and deemphasized field collection activity for M&R taxes. These changes increased output with the Division closing more tax notices than it received. Increased compliance with payment agreements reportedly led to improved case closure rates. During calendar year 2012, with enhancements to TIMS and the Division Director compiling monthly performance data, the Division increased its ability to monitor what it calls "critical success factors" for collection activities such as:

- dollar amount abated by the Division,
- dollar amount collected by each collection team,
- number of tax notices currently assigned to each collection team,

- number of liens filed respectively by each collection team,
- dollar amount of outstanding tax notices for calendar years 2008 through 2011,
- number of missing monthly letters issued to M&R operators,
- number and dollar amount of tax notices assigned to the out-of-state collections agency, and
- dollar amount the Division determined to be uncollectible.

Table 4 details the value and quantity of the Division's caseload as of June 30, 2011 and 2012.

Table 4

**End Of Year Division Caseloads
SFYs 2011 And 2012**

Tax Type	June 30, 2011				June 30, 2012			
	Value	Percent Of Total	Case Count	Percent Of Total	Value	Percent Of Total	Case Count	Percent Of Total
Business	\$24,746,115	77	3,981	47	\$21,580,329	74	3,906	42
Interest And Dividends	1,020,278	3	449	5	829,433	3	463	5
Meals And Rentals	4,421,342	14	3,485	41	4,717,444	16	4,051	44
Real Estate	687,981	2	179	2	657,298	2	177	2
Communication Services	129,870	1	46	1	306,517	1	62	1
Tobacco	58,187	0	271	3	107,359	1	371	4
Gambling Winnings	46,150	0	25	0	79,386	0	47	1
Others	897,680	3	31	1	905,411	3	44	1
Totals	\$32,007,603	100	8,467	100	\$29,183,177	100	9,121	100

Source: LBA analysis of unaudited Division of Collections data.

Non-collections Activities

In addition to collecting delinquent taxes, some of the Division's employees also license M&R operators, sell tobacco stamps, and conduct compliance operations, such as performing tobacco stamp checks at retailers. The Division also engages in hearings, pre-hearings, and suspensions and revocations of meals and rentals licenses.

Information Management And Information Technology (IT)

During the audit period, the DRA implemented improvements to TIMS, its main information system, and automated manual processes. TIMS was developed in 1989 and maintains data on major taxes, including M&R, interest and dividends, business profits, and business enterprise. There are separate IT system applications for six other taxes, including the communications services tax, tobacco tax, and various miscellaneous taxes. Each application was developed

internally with little provision for interaction with either TIMS or the other tax applications. There was no efficient way to integrate data from different tax systems, even for the same taxpayer.

In the 2009 session, the Legislature appropriated \$7 million for system improvements to permit data extraction and manipulation, and productivity measurement. Improvements were intended to link the disparate applications which were limiting the efficiency and effectiveness of the Department. Changes included creating a single view of the taxpayer for different tax types, automating workflow, providing for electronic filing and payments, and implementation of smart forms for scanning. Improvements were also intended to make TIMS more user-friendly. System components, such as business intelligence, geographic information, and voice over internet protocol, were implemented through SFY 2012. The improvements were to be added to the legacy TIMS structure, creating a more integrated system and to be carried out over a two-year period.

The ongoing upgrade of the Division's information technology systems, along with DRA-wide employee reductions, resulted in tax return processing backlogs during calendar year 2012. This also negatively affected the timely identification of delinquent taxes during this period. As of July 2013, the systems' implementation process was reportedly nearing completion.

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ADMINISTRATION

The Department of Revenue Administration (DRA) is responsible for developing and implementing controls to efficiently and effectively carry out operations while ensuring compliance with applicable laws and regulations. The Division of Collections (Division) is responsible for developing the detailed policies and procedures necessary to aid mission accomplishment, improve accountability, minimize operational problems, provide reasonable assurance it achieves its goals, and help safeguard public resources. We found the DRA lacks administrative rules and policies for the collection of delinquent taxes as well as procedures to help ensure equitable treatment of taxpayers. The DRA's management information systems have weaknesses in controls that would help ensure tax data are accurate, reliable, and timely. The DRA has not taken appropriate steps to identify, analyze, and mitigate external and internal risks to its operations.

Observation No. 1

Improve Abatement Management

Division guidance and practices for managing abatement requests differed from statute, administrative rule, and DRA policy. Department-level abatement management infrastructure relied on inadequate administrative rules and policy, and inadequate oversight.

DRA Administration

The Commissioner may abate taxes, additions to taxes, interest, and penalties when wrongfully assessed, amounts are uncollectible in his judgment, the administrative and collection costs do not warrant collection, or for other good cause shown. Functionally, abatements were either contested or administrative. Contested abatements involved a requesting taxpayer, while administrative abatements were carried-out by the Division without taxpayer involvement. Separate processes for each type were not codified in administrative rules or DRA policy. Statute and administrative rules provided for handling requests for abatement using a single defined, deliberate process.

Abatement Rules Insufficient

We found administrative rules for abatements were not clear or comprehensive. The rules for taxpayers seeking an abatement intermingles that process with requests for abatements from municipalities. Rules also require abatement requests be submitted to the DRA's Hearings Bureau; however, the DRA changed that process and now directs requests to the Division for approval and does not ensure the requirement to review the abatement request within 120 days is being met. We found the DRA has not codified in rules several types of abatements, such as

those resulting from bankruptcies, voluntary compliance, offers-in-compromise, and those determined to be not worth pursuing or uncollectible.

Abatement Reasons Not Well Documented

According to Division staff, abatements received approval when they were in the “best interest of the State.” Statute, administrative rule, DRA policy, or Division guidance did not define or otherwise structure “best interest of the State” determinations made by Division staff to support abatement decisions. There were at least 19 reasons for approving an abatement request, such as the result of an offer-in-compromise, an uncollectible determination, a hardship finding, a minimal amount not worth pursuing, and a good filing history. Also among the 19 reasons for an abatement approval was an “other” category. Our review of Division abatement records found inconsistent use of these categories. We also found the “other” category was the single most common reason given for an abatement by the Division during the audit period, at times apparently used for the same purpose as another specific category. Best interest judgments were made on a case-by-case basis. In our file review of 57 Division cases, these decisions were inconsistently documented and supported. Consequently, we were unable to consistently determine whether decisions that amounts were uncollectible, collections costs exceeded amounts owed, or other good cause existed were supported. Statute requires the Commissioner make and maintain records containing adequate and proper documentation of policies, procedures, decisions, and essential transactions.

Delegation Imprecise And Inconsistently Adhered To

The Commissioner delegated to the Division Director authority to abate amounts of \$5,000 or less. We found the delegation of abatement authority from the Commissioner to the Division Director could be more precise.

- The delegation did not include the authority to abate fees, but during our case file review we found fees were abated by the Director.
- The delegation commingled the term “waive” with abatement, but neither statute, administrative rule, nor the delegation itself defined it. A waiver is a separate process described as a reduction of an amount owed when the taxpayer did not in fact incur the debt, which might occur in cases of DRA error. It is unclear what role a waiver may play in abatement processing. The Director could abate \$5,000, but could waive \$2,500, although this value was not included in the delegation of abatement authority.
- The Director was permitted to abate \$5,000, per taxpayer, per filing period, or \$60,000 covering one year of meals and rentals (M&R) monthly filings; \$5,000 each for business and interest and dividends (I&D) taxes; \$5,000 for real estate transactions; and an indeterminate amount on a case-by-case basis. Our file review of 57 cases indicated the Director abated more than \$5,000 in two cases (four percent), including nearly \$154,000 in one case.

- The delegation permitted abatement of interest, but only to the extent the original debt giving rise to the interest was abated. Our file review demonstrated 25 abatements included some or all of the interest owed, but none of the original debt.
- The delegation mandated monthly reporting on approved abatements, but this requirement was not adhered to due to technology changes, which reportedly made approved abatement data available directly to Department management.

Division-level Management

The Division granted over 5,700 M&R, business, I&D, and real estate transfer tax abatements, valued over \$1.9 million in taxes, interest, penalties, and fees, during the audit period. The Division lacked policy and procedure on handling abatement requests. Division guidance and practice led to different requests for abatement being treated inconsistently.

Delays In Processing Requests For Abatement

Processing a request for abatement might be held pending interest or tax payment, and if a request was still pending after 120 days from receipt of the abatement request, a denial letter or request for extension would be processed. Statute neither provided for holding requests for abatement pending payment nor allowed for extensions of time permitted to handle requests. The Department's public guidance provides "payment of the liability is not required to pursue an appeal" and statute and administrative rules require a request be approved or denied within 120 days of receipt or the matter becomes a contested case and a hearing is required.

Inadequate Documentation

During our file review of 57 randomly selected collections cases, we found 21 cases with 80 abatement transactions. We found many abatement transactions were inadequately documented:

- 13 of 21 cases (62 percent) lacked evidence an abatement was requested by the taxpayer,
- 16 of 21 cases (76 percent) had no written request for an abatement,
- eight of 21 cases (38 percent) did not contain an abatement worksheet,
- nine of 21 cases (43 percent) had a different amount of money abated than specified on the supporting hardcopy abatement worksheet, and
- four of 21 cases (19 percent) with inconsistent use of reason codes for abatement approval.

Recommendations:

We recommend DRA management:

- **refine the abatement authority delegation to include authority to abate fees;**
- **define the "best interest of the State" when applied to abatements;**
- **clarify "waive" in the abatement delegation;**

- **monitor the Director’s abatement decisions to ensure compliance with his delegated authority;**
- **delete monthly reporting requirements from the abatement delegation if technological advancement has made separate reporting redundant; and**
- **require the Division fully document reasons for abatement transactions.**

Auditee Response:

Concur.

Department delegations will be updated and refined immediately. The Department will put in place a reporting process to monitor Division abatement decisions.

Observation No. 2

Promulgate Administrative Rules For Payment Agreements

There are no administrative rules regulating payment agreements for delinquent taxes between the DRA and taxpayers. DRA statute requires the Commissioner adopt rules regulating the collection of taxes and specifically allows the DRA to have written installment payment agreements to facilitate the collections of delinquent taxes if the taxpayer has clearly demonstrated an inability to pay in full. Payment agreements are a collections means and, by not promulgating rules for payment plans and providing Compliance Officers (CO) with flexibility in implementing plans, the Department may compromise enforceability and risk inconsistent treatment of taxpayers.

We reviewed a randomly selected sample of 26 tax notice cases reported to have entered into a payment agreement, and found no evidence of written payment agreements in 14 (54 percent). There was also no evidence in the files showing the Division Director’s approval of the payment agreement in 14 of the 26 cases (54 percent). The former DRA Commissioner delegated to the Director of Collections “the authority to execute installments... not to extend beyond a six month period.” We found four instances in which the documentation showed the payment agreement was designed to exceed six months. We found only one instance in which the documentation showed the CO informed the taxpayer they could not set up a payment agreement for more than six months. Further, in 19 of the 26 cases (73 percent) the taxpayer failed to adhere to the payment arrangement, but only six of the payment agreements were terminated for non-compliance.

Recommendation:

We recommend the DRA promulgate administrative rules for payment agreements in order to provide clear requirements for both the DRA and taxpayers. The rules should specifically address how taxpayers must document their inability to pay and to ensure the Division obtains and maintains written payment agreements.

Auditee Response:

Concur.

The Department will first determine whether it will seek statutory changes, and then address promulgating the appropriate administrative rules.

Observation No. 3

Adopt Administrative Rules For Liens

State laws require the DRA to: 1) place a lien on taxpayers' properties for all taxes, penalties, and interest; and 2) specifically require using a lien when the DRA enters into an installment payment agreement with a taxpayer. While State laws require the use of liens, there are no administrative rules that explain how the Division should implement these requirements, only internal guidance. We found the Division does not consistently place liens on taxpayers' property, even when payment arrangements are used.

We reviewed 25 randomly selected tax notice cases reported to have a lien and found 22 instances (88 percent) where no lien was set within its 90-day guideline when the Division was unable to collect all money owed. The average number of days between a tax notice being assigned to the Division and the date a notice of lien was sent to banks was 387 calendar days for seven cases in which the Division was seeking to identify taxpayers' bank accounts for possible seizure. When a payment agreement is made with a taxpayer a lien is required; however, we found in 15 of 26 cases (58 percent) the Division did not file a lien before entering into a payment agreement. We also found only eight of the 25 case files (32 percent) with a lien retained a completed tax lien form for a county registry of deeds or the Secretary of State documenting the action taken by the Division.

Guidance from the Division's *Technical Assistance Manual* (TAM) gives COs some flexibility in deciding when or if to file liens. When placing liens, the TAM suggests the CO take into consideration the taxpayer's situation, the amount owed to the State, cooperation of the taxpayer, the taxpayer history with the Department, and if placing a lien is in the best interest of the State. The TAM suggests liens not be used when the tax notices are below certain thresholds. However, liens are regarded as one of the most powerful tools for collecting delinquent taxes.

The TAM also suggests the CO seek voluntary compliance from taxpayers prior to using involuntary collection methods like placing liens. Further, the TAM suggests if the CO arrives at an impasse, a lien should be filed immediately and once the CO determines a taxpayer cannot pay the bill due to lack of funds and is not making estimated payments for future taxes, a lien is probably necessary to immediately protect the State's interest in any existing assets. Timeliness in filing liens is important, as the first-filed lien generally has priority over other liens on the same property.

Lack of administrative rules has allowed greater flexibility in determining when liens should be used by Division employees. However, this flexibility comes with the risk of not treating taxpayers equally. An administrative rule is defined as each regulation, standard, or generally applicable statement a State agency uses to implement, interpret, and make specific policy, procedure, or practices binding on persons outside the agency.

Recommendation

We recommend the DRA adopt administrative rules for its use of liens as a collection tool and ensure they are consistently applied.

Auditee Response:

Concur.

The Department will begin drafting appropriate administrative rules to address the Department's use of liens.

Observation No. 4

Technical Assistance Manual Should Be Authoritative

The Division's TAM described "some" actions the Division could take to collect unpaid taxes, penalties, interest, and administrative expenses, and other supplemental directives provided guidance for Division employees during the audit period. However, this guidance only *outlined* the authority and responsibilities of the Division and included only *some* of the steps taken to collect. Some Division employees reportedly used the TAM as "advisory only." Division employees were expected to operate under their own discretion, within the generally established boundaries of guidance. We found inconsistent operationalization of common procedures among Division employees, some key functions were undefined, and guidance was lacking in other areas.

Written documentation of the DRA's control structure should exist, be readily available, and be codified in management directives, policies, and manuals. Management exercises control through these policy and procedures manuals, directives, and other formal instructions.

While every collections action should be "in the best interest of the State," compliance with guidelines was inconsistently documented. For example:

- The Division had no explicit guidelines, policy, or procedure on negotiating settlement agreements; instead, they rested on employee judgment. Three of the 57 collection cases we reviewed, as noted in Observation No. 1, contained settlement agreements that were entered into during the audit period. Each lacked evidence the collection of taxes would be a financial hardship for the taxpayer, and also lacked

evidence the Director approved the settlement agreement prior to the taxpayer signing the agreement.

- Guidance provided a detailed abatement request was to be in writing, a CO recommendation based on taxpayer history was to be made, and each abatement was to be properly documented with supportable evidence and comments. Of the 57 collections cases we reviewed, as noted in Observation No. 1, we found 21 (37 percent) contained one or more abatements issued during the audit period. In 16 of these 21 cases (76 percent), there was no written request for abatement and eight cases (38 percent) did not contain the Division's abatement request worksheet which might have supported the abatement decision.

Timeliness in taking collections actions is reportedly essential for effective collections. However, guidance did not provide an overall timeline by which key procedures *must* be completed and when guidance established timelines, they were infrequently met.

- In our file review of 57 collections cases, we found 28 cases (49 percent) with tax notices assigned to the Division during the audit period. In 22 of those 28 cases (79 percent), there was no evidence the Division collected amounts owed by the 60-day goal established in guidance.
- We found no evidence in each of nine applicable cases (100 percent) the responsible CO timely scheduled a meeting with the Director after 90 days to evaluate why assets could not be located and seized.
- Of the 25 liens issued during the audit period for the 57 cases we reviewed, on average it took 435 days from assignment to the Division for a lien to be placed. Division guidance indicated liens should be placed within the same 90-day period from the date of assignment to the Division, and only two (eight percent) met the 90-day guideline.

Further, guidance on filing liens was conflicting and lien placement decisions were made on a case-by-case basis, with inconsistent practices reported among employees. Yet, these practices generally sought to avoid lien placement.

Recommendation:

We recommend the DRA develop, issue, and adhere to an authoritative policy and procedure manual to codify Division policies and procedures to help ensure compliance with statute and consistent collection practices.

Auditee Response:

Concur.

The Department concurs with the Recommendation, however, post audit period, the Department completed an update of its Collection Division Technical Assistance Manual (“TAM”), and such TAM currently addresses the concerns outlined in Observation No. 4.

Observation No. 5

Improve Records Management

The Division lacked a records management program, including formal procedures and a definition of what constituted a complete case. Further, the Division did not follow the DRA retention policy. Reliable information and records enable agency operation and management control. Statute requires the Commissioner implement a records management program and make and maintain adequate and proper documentation of policies, decisions, procedures, and essential transactions. Records help protect the legal and financial rights of the State and of persons affected by the DRA’s activities. Records should demonstrate proper execution of transactions and events, be complete and accurate, facilitate tracing a transaction’s lifecycle, and be readily available.

Division employees had difficulty finding some records we requested. Based on our review of the 57 collections case files noted in Observation No. 1, we found Division actions were inconsistently supported by the records available, rendering many un-auditable. For example, we found:

- 17 of 25 (68 percent) of the cases where a lien was reportedly filed did not include evidence a lien was actually filed;
- 22 of 26 (85 percent) of the cases with payment agreements had no evidence a taxpayer demonstrated inability to pay in full;
- 14 of 26 (54 percent) of the cases with payment agreements had no written payment agreement;
- 16 of 21 (76 percent) abatement cases had no written request for abatement; and
- nine of 57 (16 percent) cases where evidence indicated the record was temporarily lost, misplaced, or overlooked.

Statute provides records: 1) made or received by public officials are State property, 2) shall not be disposed of except as provided by law, and 3) not warranting longer retention, may be destroyed four years after creation. The DRA’s records retention policy does not address Division records and provides any records not addressed by the policy “shall be retained by the Division until the Policy Committee determines the minimum retention period for that record and amends...policy accordingly.” However, Division employees reportedly had a practice of

shredding case-related documents when they believed the case would not come back as a case in the future. By disposing of records, the Division was noncompliant with the DRA's record retention policy.

Recommendation:

We recommend the DRA promulgate, implement, and oversee a statutorily compliant records management program for the Division.

Auditee Response:

Concur.

Although data sought during the audit period was available, it was segregated in different files and locations based upon differing Departmental needs, such as documentation needed for LBA financial auditors, as well as differing retention schedules. Going forward, the Department will strive to improve records management by placing all relevant taxpayer data into a single record, and has already taken steps to document this approach in its updated TAM.

Observation No. 6

Strengthen Information Technology (IT) Control Environment

During the audit period, we found the IT control environment in need of significant improvement. Controls over implementing new systems did not follow Department of Information Technology (DoIT) general guidance, disaster recovery and business continuity plans were not readily accessible and tested, physical security controls over access to the DRA facility were not always updated timely, some user IT system access settings were not updated or appear to exceed requirements for their duties, and user accounts were not always disabled according to DoIT policy. A properly designed and functioning IT control environment helps: 1) reduce internal and external operational risks, 2) increase the efficiency of business operations, 3) ensure only authorized changes are made to IT systems, 4) protect sensitive data, and 5) provide for recovery in the event of a disruption. Properly designed and enforced IT controls, such as formalized change control procedures, segregating incompatible duties, user access and password rules, physical security, and continuity of operations and disaster recovery planning provide management with reasonable assurance business functions operate as designed with minimal disruption.

System Development

DoIT's Systems Development Methodology, which State agencies should follow, stresses the need to conduct extensive testing before introducing a new or modified system into a live production environment. Proper testing can save human and capital resources later because it allows an agency to identify and correct programming or processing errors before they have an

impact on business functions. However, we found the DRA lacked strong system development controls, which caused interruptions to business processes and problems with data integrity.

The DRA implemented a scanning system in March 2012 to electronically process tax returns and other tax documents in its efforts to improve efficiency over the former manual process. The system scans tax documents and checks, translates the images into text and numbers, and stores the data produced by the scan into a designated holding queue. The data are pulled from the holding queue in an overnight batch process and appended to the DRA's *Taxpayer Information Management System* (TIMS) each night. However, the DRA did not conduct testing in a simulated production environment before implementing the scanning system and experienced historically high failure rates with its overnight batch process and problems with data integrity. Reportedly, the DRA previously experienced three to four overnight batch process failures annually, but during the middle two quarters of State fiscal year 2013, there were 38 overnight failures. The high rate of overnight batch failures disrupted DRA business processes and required an unknown amount of staff time to fix. DRA staff reported they have identified the most common causes of the overnight failures. However, the DRA could not provide statistical or aggregated reports demonstrating the DRA methodically tracked the type and frequency of problems causing the overnight failures.

Disaster Recovery And Business Continuity Planning

In our 2008 Financial Audit report, Observation No. 1, Formal Risk Assessment Process Should Be Established, we found the DRA had neither established nor tested "a comprehensive, documented, Department-wide disaster recovery and business continuity plan." Plans should be easily accessible and stored in a location independent of the systems they are designed to recover. We recommended the DRA update, expand, and test its disaster recovery and business continuity plans; the Department concurred. However:

- the DRA's disaster recovery and business continuity plans were not readily accessible, taking the Department over 2 months to provide us the documents after we initially requested them;
- the plans lacked procedures describing how the DRA would recover its IT systems and continue business operations in the event of a disaster;
- the plans were untested; and
- the plans were stored on the same IT system they were intended to recover, limiting or preventing access to them in the event of a major loss of IT systems.

Physical Access

The DRA employed a physical access control system requiring users to swipe a magnetic card to access the building and points throughout the building. The building was also outfitted with an alarm system that detects after-hours access. We identified physical access control weaknesses including:

- The DRA could not document staff review of the physical access control or alarm systems' activity logs to identify after-hours access or other unauthorized activity.

- We observed the server room door open and unlocked with the keys left in the door on multiple occasions. The DRA's "Computer Room Access" policy specifies the server room will remain locked during normal business hours. However, based on what we observed, anyone who gained access to the computer room would be able to readily access the server room.
- We regularly observed an unescorted third-party vendor in the interior of DRA's building who did not have an identification badge or physical access card and was never subject to a background check.
- The DRA did not systematically monitor all DRA and DoIT employees, security personnel, and vendors who were granted access cards to DRA's building.

Application Access

We examined user access controls and found the DRA lacked adequate controls over IT system access. We found:

- The DRA did not have policies and procedures for IT system access and employed a decentralized user privilege control system reliant on the initiative and judgment of individual managers to determine appropriate access privileges for each employee.
- Two employees have access to both test and production IT environments. Best practice suggests a user should never have access to both the test and production environments because it provides them with the opportunity to make unauthorized system changes.
- Two employees shared a common administrator account and password which prevented the DRA from having a clear audit trail that would show which employee made system changes.
- One employee's system authorities appeared to greatly exceed those required for the employee's duties.

User Account Management

The DRA appeared to lack regular reviews of user activity to identify unauthorized activity, and could not provide any policies or procedures related to reviewing user operating logs or evidence demonstrating it monitors user activity. DoIT policy and procedure specifies user accounts should be disabled after 45 days of inactivity. We reviewed the files of eight former DRA employees who previously had access to DRA's IT systems. We found the DRA did not disable the accounts of three of eight (38 percent) former employees until approximately one year after they stopped working at the DRA.

Recommendations:

We recommend DRA management strengthen the IT control environment by:

- **establishing system development controls to ensure new and modified systems are implemented according to DoIT's System Development Methodology;**

- **creating and testing operational disaster recovery and business continuity plans to facilitate IT system recovery and continuous operation in the event of a disaster;**
- **improving physical access controls to DRA’s building, including formalizing procedures for identifying after-hours access, locking server rooms and limiting employee access, enforcing its existing policies for access to the building, and document its monitoring of building access privileges;**
- **increasing controls over user access privileges to IT applications by establishing a formal user access privilege policy and procedure, not providing employees with access to both test and production environments, eliminating the practice of shared user accounts and passwords, and reviewing current employee access privileges to ensure they are appropriate based on business needs; and**
- **creating and implementing a user account management policy and procedures, to ensure terminated employees do not have access to DRA’s IT systems and user activity is routinely monitored.**

Auditee Response:

Concur In Part.

Bullet No. 1 relates to system development controls under the purview of the Department of Information Technology (“DOIT”). According to DOIT, DOIT embedded staff always follow the System Development Lifecycle methodology for each internal project supporting the Department. DOIT also follows a very strict process for identifying and addressing all internally managed program changes. DOIT states that the challenge is holding vendors to the same standards and accountability since these contracts are held with the agency and not DOIT. Going forward, DOIT will strive to ensure that vendors procured by the Department are working in conjunction with the System Development Lifecycle methodology per DOIT guidelines. Bullet No. 2 relates to disaster recovery. The Department agrees that issues surrounding disaster recovery and Continuity of Operations Plans must be updated, enhanced, and tested. Bullet No. 3 discusses physical access. DOIT and the Department agree that there needed to be more stringent controls around access to the server room and steps have already been taken to further secure access to the computer room. Bullet no. 4 addresses the user access security matrix. The Department does review, on a twice yearly basis, all employees’ IT access privileges to ensure they are appropriate based on business needs. Nevertheless, the Department agrees it will implement a formal written policy to that effect. Additionally, DOIT monitors and disables Department user network accounts after 45 days of inactivity. Bullet no. 5 relates to user access privileges to IT applications. DOIT will continue to work with the Department to refine the current procedures and implement stronger controls. DOIT represents that in certain circumstances it is necessary for IT and business users to have access to both test and production environments. Nevertheless, DOIT concurs with this observation and is creating unique user IDs for each operator.

Observation No. 7

Improve Risk Management

The DRA does not take adequate steps to identify, analyze, and mitigate threats to its business processes and supporting IT systems. We found the DRA: 1) lacked written policies and procedures, 2) did not complete risk assessments, 3) had weak controls over third-party service providers, 4) had no recent substantive external or internal audits of IT systems, 5) lacked a quality control system to identify and correct bad data, and 6) did not designate an employee responsible for managing risk. Failure to regularly assess external and internal risks threatens operations and supporting IT systems, and leaves the DRA without an adequate control environment to effectively identify and mitigate exposures that could negatively impact business functions.

The DRA is responsible for collecting the State's taxes and providing tax information to the Governor and General Court for public policy decisions. Therefore, it is incumbent on the DRA to regularly assess the risks that potentially threaten its business operations, IT systems, and taxpayer data to ensure it effectively collects and reports the State's tax revenues. We examined the DRA's controls over risk management.

Absence Of Formalized Policies And Procedures

An adequate control environment ensures compliance with rules and laws; business processes are effective, efficient, and completed consistently; and information and supporting IT systems are protected. Written policies and procedures are the basis for an adequate control environment and statute requires the Commissioner to make and maintain adequate and proper documentation of policies, decisions, procedures, and essential transactions. We found the DRA does not maintain written policies and procedures for:

- reviewing user network activity or application operating logs to deter, prevent, or identify illicit or unauthorized activity;
- maintaining the security of its voice over internet protocol phone system;
- backing-up servers and data;
- disabling user accounts of former employees to prevent unauthorized access;
- ensuring physical security;
- reviewing user access privileges to IT systems; and
- making normal or emergency changes to programs and applications.

When an agency does not formalize procedures, multiple employees may perform the same activities producing inconsistent or incorrect results.

Risk Assessments Are Not Completed

In our 2008 Financial Audit report, Observation No. 1, Formal Risk Assessment Process Should Be Established, we found the DRA had “not conducted a formal risk assessment and does not

have risk assessment policies and procedures in place to continually assess where and how things could go wrong, evaluate the likelihood of those occurrences, and establish reasonable responses to those potential occurrences.” We recommended the DRA “develop formal documented risk assessment policies and procedures that establish and formalize a risk assessment process and provide for a regular and continuous risk assessment of its operations.” The DRA concurred and agreed to develop a formal risk assessment process. Further, DoIT policy and procedure requires the DRA conduct biannual risk assessments. However, the DRA did not provide documentation showing any completed risk assessments since we issued our 2008 audit report.

Limited Oversight Of Third Party Service Providers

In our 2008 Financial Audit report, Observation No. 5, Understanding Of Relevant Controls At Service Providers Should Be Documented, we found the DRA had “not formally considered and reacted to how controls or weaknesses at its service providers could impact the Department’s financial statement.” We recommended the DRA address the weak controls over service providers and the DRA concurred. However, we found the DRA did not exert sufficient control over service providers, as it never required service providers submit either Statement on Auditing Standards (SAS) No. 70 or its successor, Statement on Standards for Attestation Engagements (SSAE) No. 16, reports to demonstrate the service providers maintained strong internal controls over DRA-related transactions.

Internal Audit Function Not Utilized

The DRA has not regularly reviewed and evaluated its control environment to ensure established controls are functioning and achieving their intended purposes. The DRA employs an internal auditor which should help ensure a strong control environment. However, we found the DRA did not perform any internal audits during or after the audit period. The internal auditor had been assigned unrelated duties. The only external audit the DRA received during the audit period was as part of the State’s *Comprehensive Annual Financial Report* which determined whether the revenues the DRA reported were reasonably stated in all material respects for the State’s financial statements taken as a whole. No DRA examination of the effectiveness or efficiency of business processes or internal controls occurred.

Quality Control Testing Not Performed

An adequate control environment helps ensure data are reliable, accurate, and available. During and after the audit period, the DRA implemented front-end controls to help ensure the data going into IT systems were reliable and accurate. However, we reviewed DRA data and identified a number of inconsistencies. We identified records with illogical expiration dates and duplicate records. DRA and DoIT employees reported the DRA’s IT systems contain inaccurate data. We also found the DRA did not conduct quality control testing to identify potentially inaccurate data in its systems and the DRA lacked an established procedure to identify data problems. Instead, inaccurate data were identified and corrected on an ad hoc basis.

No Designated Risk Management Administrator

DoIT policy specifies DRA management is responsible for risk management and establishing internal controls related to IT systems. The DRA should identify one employee, such as an information security officer or administrator, to assume related responsibilities. The DRA has not appointed an information security officer or other employee to systematically manage Department-wide risks, including IT-related risks.

Recommendations:

We recommend DRA management improve its risk management controls by:

- **establishing written policies and procedures for significant business processes;**
- **conducting and documenting biannual risk assessments;**
- **increasing oversight over third-party service providers, such as requiring them to submit SSAE No. 16 reports;**
- **regularly completing internal audits to ensure controls are functioning as intended;**
- **creating and implementing a quality control system to ensure data are accurate; and**
- **designating an employee responsible to identify, evaluate, and manage external and internal business operations and IT systems risks.**

Auditee Response:

Concur In Part.

The Department agrees that the internal audit function needs to return and the Department's internal auditor will re-implement a formalized audit program for the Department. Bullet No. 2 addresses risk assessments. The Department further agrees with this Observation and will work with DOIT to implement a formalized process based on the DOIT policy. DOIT, per its Risk Management Assessment policy, must assist the Department with all risk assessment activities and work with the Department in completing this process as they require. Bullet No. 5 relates to creating a quality control system. The Department will work with the vendor and DOIT to assess the data currently in the TIMS application for accuracy. During the audit period, the Department did have in place an information security officer who recently left State employment. The Department will designate a new information security officer pursuant to the recommendation in Bullet No. 6. DOIT will offer assistance to this person as required.

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**STATE OF NEW HAMPSHIRE
DEPARTMENT OF REVENUE ADMINISTRATION
COLLECTION OF DELINQUENT TAXES**

OPERATIONS

Program operations are the activities that transform resources and data into services to obtain the desired outcomes. We identified weaknesses with how the Department of Revenue Administration (DRA) collects delinquent taxes, resulting in some inefficiencies and questionable effectiveness. One way to increase the likelihood of collecting delinquent taxes is to start collection procedures on tax notices as soon as possible; yet, we found problems with the timeliness of the DRA's collection process. Because of the lack of rules and publicly available information, taxpayers are not sufficiently apprised of settlement and payment options and requirements. Additionally, DRA officials and Division of Collections (Division) employees commented on the need for training, which could improve the Division's efficiency and effectiveness.

Observation No. 8

Ensure Timely Handling Of Collection Cases

The Division's mission and function is to collect State tax revenue. The more a tax liability ages, the less likely it will be collected. Businesses dissolve and the statute of limitations requires timely DRA action. The State may also compete with the federal Internal Revenue Service and other creditors for assets of troubled businesses. When a business is defunct, debt is more likely to be written off since collection becomes unlikely. Also, compounding interest and penalties increase the total liability and contribute to an inability to pay. Timely debt collection is in the State's best interest.

Collecting debts within 60 days of assignment was the Division's goal; after 90 days, uncollectible cases were to receive a management review. However, we found: 1) unexplained delays in assigning cases to the Division, 2) no formal or informal process or efforts to expedite tax notice referrals to the Division, 3) the Division identified no issues with the timeliness of tax notice referral during the audit period, 4) no systematic tracking and reporting on the timely processing of delinquent tax cases by the Division, and 5) the DRA's *Taxpayer Information Management System* (TIMS) lacked an automated process for identifying collection cases which have been inactive.

Assignment Of Non-Meals And Rentals Tax Notices To The Division

During our file review of the 57 collections cases noted in Observation No. 1, we found 21 business, interest and dividends (I&D), and real estate tax notices were assigned to the Division an average of 136 days after tax notice issuance, while 34 days elapsed before Division employees made the first taxpayer contact on the debt. Our review of TIMS data identified other cases with lengthy assignment times; however, the data prevented us from quantifying the extent of the problem.

Division employees reported a variety of reasons for such a delay, such as the taxpayer not filing timely, and TIMS may detect an irregularity, which could send the record to a hold status that could only be resolved through intervention by a DRA employee. Certain record types take priority over others, and lower priority records waited. These practices contributed to delaying tax notice assignment to the Division.

Division employees reported TIMS was programmed to transfer non-meals and rentals (M&R) tax notices with amounts due to the Division 70 days after the issued date. This was to provide the taxpayer the statutorily established 60-day appeal period and a 10-day administrative period to account for potential delays with mailing and handling submissions. We found, however, TIMS was actually programmed to delay transfer of tax notices with amounts due to the Division after 80 days. This programmed delay contributed to delaying tax notice assignment to the Division.

Our review of TIMS data identified examples of business, I&D, and real estate first tax notices being assigned to the Division between 140 and 149 days after the tax notice was issued, instead of between 80 and 89 days. Data limitations prevented us from quantifying the extent of the problem. While Division management reported the 80-day auto-assign function worked as designed during the audit period, the DRA asserted: 1) the auto-assign functions had been disabled due to data quality concerns associated with implementing modifications to TIMS and 2) the 80-day period was systematically extended by an additional 60 days as the DRA issued *proposed* tax notices, providing the taxpayer with another 60-day period within which they could respond before DRA issued the *actual* tax notice. This practice further delayed collections action and we could find no statutory authority for this practice, nor any corresponding administrative rules or formal DRA policy for it. We further question whether this informal practice effectively duplicates the statutorily provided 60-day appeal period provided for any assessment.

Division Tax Notice Management

In addition to its collection responsibilities, the Division had responsibility for managing M&R taxes, to include tax notice generation, referring cases to the Audit Division, and making assessments. M&R returns were due on the 15th of each month, and, if warranted, tax notices were to be issued no later than the 25th of the same month. M&R tax notices were to be assigned for collection immediately since interest accrues daily and penalties are assessed for each month of non-filing.

We found 20 M&R tax notices contained in the 57 cases we examined. Eighteen of 20 notices (90 percent) were assigned to the Division the same day they were issued; the remaining two cases were assigned 618 and 1,242 days from their issue dates. Thirteen of 20 notices (65 percent) were issued between the 15th and 25th of the month while the remaining seven (35 percent) were not. Our review of TIMS data found other examples of M&R notices being assigned late, but we could not quantify the extent of the problem.

Recommendations:

We recommend DRA management:

- expedite assignment of non-M&R collections cases to the Division;
- assess the efficiency of the 60-day proposed tax notice practice, consider whether the practice remains valuable and whether it effectively duplicates the statutory appeal period, and promulgate administrative rules to formalize the practice if it is to remain in effect;
- consider reducing the 80-day pre-programmed assignment of non-M&R tax notices to the Division;
- determine the cause for other delays in assigning tax notices to the Division and remedy any systemic issues contributing to delays; and
- ensure the Division timely processes cases.

We recommend Division management:

- expedite assignment of M&R collections cases;
- determine the cause for delays in assigning M&R tax notices to the Division and remedy any systemic issues contributing to delays;
- expand upon efforts to measure Division and Compliance Officer performance by establishing benchmarks for case processing, including timeliness; and
- gather case data to measure the timeliness of collection actions and case outcomes.

Auditee Response:

Concur.

For Tax Year 2013, the Department will assess the tax notice system, including the areas highlighted in the bulleted recommendations.

Observation No. 9

Adopt Administrative Rules For Settlement Agreements And Offers-In-Compromise

Division guidance asserted authority for functions not found in statute or administrative rule. Division guidance provided for settlement agreements and offers-in-compromise in certain circumstances, such as taxpayer inability to pay, to avoid excessive litigation costs, when an installment payment agreement was not an option, or for effective tax administration. Settlement agreements and offers-in-compromise were components of routine Division activities. Some settlement agreements and offers-in-compromise included abatements or payment agreements, which were allowed for under State law. DRA data indicate 986 of 5,729 abatements (17

percent) were granted as a component of an offer-in-compromise, 386 payment agreements were opened during the audit period, and 17 taxpayers had both an abatement and a payment agreement during the audit period. Our file review of the 57 collections cases noted in Observation No. 1, indicated three (five percent) had an offer-in-compromise.

The powers to negotiate settlement agreements and entertain offers-in-compromise were not contained in statute or administrative rule and neither term was defined. Both were collections means and the Commissioner was obligated by statute to adopt collections-related rules, rules for submissions or requests by the public, and rules of practice. Further, the Commissioner was required by statute to make and maintain records containing adequate and proper documentation of the DRA's organization, functions, policies, and procedures.

Without codification, the general taxpaying public may not know how to apply for settlement agreements and offers-in-compromise. Further, employees have no process to follow or criteria upon which to rest decisions, potentially resulting in inconsistent or inequitable outcomes.

Recommendations:

We recommend the DRA promulgate administrative rules and policy regulating the use of settlement agreements and offers-in-compromise before continuing their use. We further recommend the Division formalize procedures to operationalize DRA administrative rules and policy.

Auditee Response:

Concur In Part.

The Department will review its policies and procedures in this area and will determine whether administrative rules should be promulgated or more formalized procedures need to be put in place.

Observation No. 10

Need To Publicize Payment Options

Taxpayers may not be uniformly informed of payment options due to unpublished practices by the DRA. The DRA has not consistently nor completely made public the payment options available to taxpayers with delinquent taxes, interest, and penalties. The DRA does not make available instructions, forms, or a listing of the factors it may consider when making payment agreement or abatement decisions. Instead, these options may be described to taxpayers at the discretion of Division employees.

Payment Agreements

The DRA’s website informs taxpayers they may request an installment payment agreement for any taxes, penalties or interest owed, but these agreements are made at the discretion of the Department; there is no further published guidance or instructions. By law, the DRA may enter into a payment agreement if it determines the agreement will facilitate collections and the taxpayer has demonstrated inability to pay in full. Internal guidance from the Division’s *Technical Assistance Manual* (TAM) suggests a Compliance Officer (CO) may propose a payment arrangement to a taxpayer and that the taxpayer submit a written proposal.

Abatements

Statute gives the Commissioner latitude in deciding when to abate taxes, interest, and penalties. However, the DRA’s website only states an abatement can be sought when a taxpayer relied on written advice from the Department that is proven to be erroneous as long as the taxpayer provided complete and accurate information in the written request for advice. Yet, there are other reasons the DRA may grant abatements. The delegated authority from the Commissioner to the Division Director provides “reasonable cause criteria” as “guidelines only” which may be supplemented by the Director’s best judgment when abating penalties. Factors to be considered include timeliness of mailing, death or serious injury, unavoidable absence, unintentional destruction of records, and unobtainable records. The DRA’s management information system tracks additional reasons for abating taxes, interest, and penalties, such as:

- inability to pay,
- hardship documented - inability to pay,
- good filing history,
- first request for abatement,
- taxpayer overseas (other than vacation),
- bankruptcy,
- voluntary compliance,
- offer-in-compromise,
- uncollectable (no assets), and
- other acceptable explanation.

While the Division has internal guidance in its TAM for granting abatement requests, it is not publicized. By not publicizing instructions, forms, or guidance describing the reasons payment plans and abatements may be granted, or the information taxpayers should provide to support their requests, the DRA risks not treating taxpayers equally.

Recommendation:

We recommend the DRA provide sufficient guidance on its website explaining the circumstances by which taxpayers can seek payment agreements and abatements.

Auditee Response:

Concur.

The Department engaged DOIT in May, 2013 to work with the Department to update its website to include information on payment agreements, abatements, and other matters relevant to the collections process. The improved website will be a vital resource for users such as taxpayers, tax practitioners, Legislators, other State agencies, and the general public to obtain forms, form instructions, laws, rules and publications of the DRA. The site will also educate the public about various tax relief programs as well as provide an efficient means for the public to get quick answers to frequently asked questions. Significant enhancements will include: improved navigation of the website for users; improved updating capabilities for DRA staff; a clean, minimalist design that is visually appealing, easy to navigate and very interactive; and a one-stop design for all tax-related matters.

Observation No. 11

Identify Training Needs And Develop An Appropriate Employee Training Program

The DRA has not consistently provided training to Division employees to enhance their knowledge, skills, and capabilities in collection techniques. Appropriate training can help maximize the effectiveness and efficiency of the collection process. Inadequate training may have contributed to employees' inconsistent handling of cases we found in our file review.

Interviews with DRA personnel indicated no continuing professional education was provided for the Division during the two-year audit period. We also noted a lack of general training for employees on collection practices. Interviews with management and employees identified dissatisfaction with the lack of training. Informal training was limited to management guidance during staff meetings and on individual cases.

The Division's TAM is intended as a reference source. The Division Director views the TAM as providing guidance, with a "suggested schedule" for employees to follow; it is not meant as a training tool. However, Division employees view the TAM differently; four use it as guidance, one as a training tool, one uses it for both, and two do not typically rely on it.

Continuing professional education enables employees to maintain skills and keep informed of changes in procedures. Management should identify appropriate knowledge and skills needed for various jobs and provide training so all personnel possess and maintain a level of competence that allows them to accomplish their assigned duties. DRA management acknowledged there was a need for continuing professional education.

Recommendations:

We recommend the DRA identify employee training needs and develop an appropriate training program for Division of Collections employees. We also recommend the DRA include appropriate funding for this training in its biennial budget requests.

Auditee Response:

Concur.

The Department can provide internal training relative to the various needs assessed, to the extent internal resources are available. The Department will further plan for and seek budget approval in the next biennium for relevant external training opportunities.

Observation No. 12

Improve Interdivisional Communication

Interviews of DRA employees identified a need for improved communication between the Collections and Audit Divisions to provide greater access to each other's case notes.

Division of Collections employees stated each division typically works independently of the other and there is limited sharing of information. When a tax notice is sent to the Collections from Audit, COs have to search for information on the taxpayer rather than reviewing case notes from the Audit Division. The Audit Division Director said information does not readily flow between the divisions.

Collections employees primarily document their notes on individual tax notices in *Remarks*, a section in the TIMS that is capable of storing such information. *Remarks* is available to other DRA units; however, no other divisions utilize the tool. By maintaining a single location for all tax notice case notes, the DRA may be able to carry out its collections functions more efficiently and effectively.

Recommendations:

We recommend the DRA consider expanding use of the *Remarks* section of TIMS to improve interdivisional communication and ensure employees from the Collections and Audit Divisions have greater access to each other's case notes.

Auditee Response:

Concur.

The Department will work to ensure all pertinent divisions and units expand the use of Remarks within TIMS to enhance communication. Post audit period, the number of Remarks posted by other divisions and units have increased dramatically, thus greatly enhancing interdivisional communication.

Observation No. 13

Discontinue Practice Of Requiring Delinquent Meals And Rentals Operators To Provide Bank Account Security Information

Division employees have guidance, which, when relied upon, resulted in imposing requirements upon M&R operators to provide bank account security information not authorized in statute or administrative rule, or provided by other formal policy. Guidance related to M&R collections activities stated the Division had “the ability to require the M&R operator to share their M&R banking information,” including the operator’s sign-on, password, and other security information.

This practice reportedly occurred infrequently during the audit period. Guidance and practice did not provide for an adjudicative process, order issuance, or appeals.

Recommendation:

We recommend the Division discontinue the practice of requiring delinquent meals and rentals operators to provide bank account security information until such time as the DRA has authority to do so in statute.

Auditee Response:

Concur.

The Department discontinued this practice during the audit period. The Department will review whether to seek a statutory change to provide a tool that will adequately secure the State’s revenue stream.

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OTHER ISSUE

In this section, we present an issue we consider noteworthy but not developed into a formal observation which would normally include criteria, condition, cause, and effect. The Department of Revenue Administration (DRA) and the Legislature may wish to consider whether this issue deserves further study or action.

Consider Additional Collection Practices

During our audit, we identified a number of collection practices the DRA currently does not use but which are employed by other states to collect delinquent taxes. We do not know how widely each is used or the effectiveness of each practice and provide the list for informational purposes and possible consideration by the DRA and the Legislature. The additional collection practices are as follows:

- intercept federal tax refunds (U.S. Treasury Offset Program),
- focus collections activities on State employees who owe taxes using wage levies,
- use a risk-based approach to debtor profiling,
- accept automatic payments in the form of electronic funds transfers,
- till tap (i.e., taking cash from a cash register during a site visit),
- revoke driver licenses,
- implement a tax amnesty program,
- revoke professional licenses issued by the State,
- centralize collections for multiple state agencies,
- use automated collection software,
- directly notify credit rating agencies,
- publicize debtors names and
- improve vendor offset programs.

Some of these practices would require statutory changes to implement.

Auditee response:

The Department neither concurs nor disagrees with this comment. Many of the recommendations listed require statutory change and the General Court's willingness to allow DRA to utilize such alternative collection measures. Over the next biennium, the Department will work with the Legislature to explore the viability of such options.

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**APPENDIX A
OBJECTIVE, SCOPE, AND METHODOLOGY**

Objective And Scope

In 2010, the Fiscal Committee of the General Court approved a joint Legislative Performance Audit and Oversight Committee recommendation to conduct a performance audit of how the Department of Revenue Administration (DRA) handles uncollected taxes. Planning work was halted due to DRA concerns about its authority to release documents needed for audit purposes. Subsequently, the Legislature amended the DRA's and the LBA's statutes to specifically allow LBA access to confidential information for performance audit purposes. We held a new entrance conference with the DRA in January 2013. In February 2013, the joint Legislative Performance Audit and Oversight Committee approved an amended scope statement, focusing our review on the DRA's Division of Collections (Division). Our audit sought to answer the following question: **Did the Division of Collections efficiently and effectively collect delinquent taxes during State fiscal years 2011 and 2012?** We confined our review to the Division's responsibility to collect delinquent taxes and did not include its licensing of meals and rentals operators or management of tax stamp sales.

Methodology

To gain an understanding of the requirements and practices for collecting delinquent taxes, the DRA's control environment and the Division's structure, staffing, and activities, we performed the following audit steps:

- Reviewed relevant State laws, administrative rules, policies, and guidance; organizational charts, job descriptions and staffing data; agency reports; contracts; website information, forms, prior audit findings; other states' audit reports; and industry literature.
- Reviewed general controls over the DRA's management information systems.
- Assessed and reviewed for potential risks of fraud.
- Interviewed DRA officials, Division personnel, and a former official of another State's revenue department.

File Review Of Tax Notices

To evaluate the Division's handling of delinquent taxes, we chose to review four taxes that generated relatively high volumes of tax notices and represent large values of delinquent taxes and associated costs. According to Division caseload data for June 2012, the following four taxes represented 95 percent of the total value of outstanding tax notices:

- business (a combination of business profits and enterprise taxes),
- meals and rentals,
- real estate transfer, and

- interest and dividends.

The Division provided lists it maintained of tax notices that either had a payment arrangement, a lien, or an abatement during the audit period. We randomly selected 20 tax notices from each of the three lists for a total of 60 tax notices which came from 57 different cases. These listings (tax notices with liens, payment plans, or abatements) were not mutually exclusive; therefore some tax notices had more than one chance of being picked for review (e.g., a tax notice could have resulted in a lien being filed and then received an abatement). We ultimately reviewed 26 tax notices with payment plans, 25 with liens, and 21 that received an abatement during the audit period. Because some tax notices had more than one chance of being selected, we could not project the results of the review back to the entire population. Based our review of tax notices data, paper files, and interviews with Division personnel, we documented the Division's practices and compared them to guidance, policy, rules, and laws.

Department Records

Tax data are maintained in DRA's management information systems, which generate and track tax notices assigned to, and subsequently managed by, the Division. We assessed the general controls over these computer systems and our review of paper files allowed us to comment on the completeness of DRA records.

The DRA provided the population of all tax notices the Division was responsible for during our two-year audit period. However, after reviewing the data, we determined they were not amendable to historical data analysis for audit purposes. We therefore chose not to produce descriptive statistics of tax notices assigned to the Division from these DRA data.

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**APPENDIX B
COLLECTION PRACTICES**

In a 2010 survey report by the National Association of State Auditors, Comptrollers and Treasurers and CGI Group Inc., entitled “Government Debt Collection: An Untapped Source for Increased Revenue and Sustained Fiscal Fitness,” presented a rank-ordered list of what respondents from 21 states indicated were the most effective debt collection strategies (including tax collection):

1. offsetting state and federal tax refunds,
2. liens, levies, garnishments, and license holds (if available),
3. automated notices and correspondence,
4. centralized collections,
5. better use of private collection agencies,
6. automated collection software,
7. electronic payments,
8. imposition of penalties and interest, and
9. increased staffing.

The survey report recommends states:

- take a broader view of debt collections strategies,
- consider centralization to achieve critical mass,
- evaluate all technology management options, and
- finance improvements with new revenue collected.

During our audit, we also identified a number of collection practices employed by the DRA and other states to collect delinquent taxes. However, we do not know how widely each is used in other states or the relative effectiveness of the following practices:

- tax warrant (i.e., a levy),
- lien on real property,
- seizure of personal or real property,
- use of private debt collectors,
- settle for less amount,
- write off delinquent tax,
- offset debt with a refund from another State tax,
- imposition of penalties and interest,
- automated notices and correspondence, and
- restrict licenses for businesses with delinquent taxes (only meal and rental operators).

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**APPENDIX C
STATUS OF PRIOR AUDIT FINDINGS**

The following is a summary of the status of two observations applicable to this performance audit found in a prior LBA report, entitled Department of Revenue Administration Financial Audit Report For The Fiscal Year Ended June 30, 2008. A copy of the prior report can be accessed on-line at our website <http://www.gencourt.state.nh.us/LBA/auditreports.aspx>.

Status Key

Fully Resolved	●	●	●
Substantially Resolved	●	●	○
Partially Resolved	●	○	○
Unresolved	○	○	○

<u>No.</u>	<u>Title</u>	<u>Status</u>		
1.	Formal Risk Assessment Process Should Be Established (see Observation No. 7)	○	○	○
5.	Understanding Of Relevant Controls At Service Providers Should Be Documented (see Observation No. 7)	○	○	○

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