Washington State Auditor's Office
Troy Kelley
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Performance Audit

Debt-Offset Programs: A tool to help Washington collect delinquent debt

December 4, 2014

Implementing a state debt-offset program and participating in the U.S. Treasury's State Reciprocal Program can help Washington collect delinquent business debt. Debt-offset programs help states recover delinquent debt by intercepting payments the state makes to businesses that owe taxes and other debts. Washington does not have a comprehensive state debt-offset program, but at least 29 states and the District of Columbia do.

We talked to nine of these states and reviewed literature on debt collection. We learned that effective offset programs are automated with wide participation across agencies providing states with benefits such as: fast collections, increased voluntary compliance, recovery of difficult debts, and efficient use of agency staff resources. We also learned about leading practices that could help guide the development and implementation of effective debt-offset programs in Washington.

Audit Number: 1012413

Table of Contents

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Executive Summary

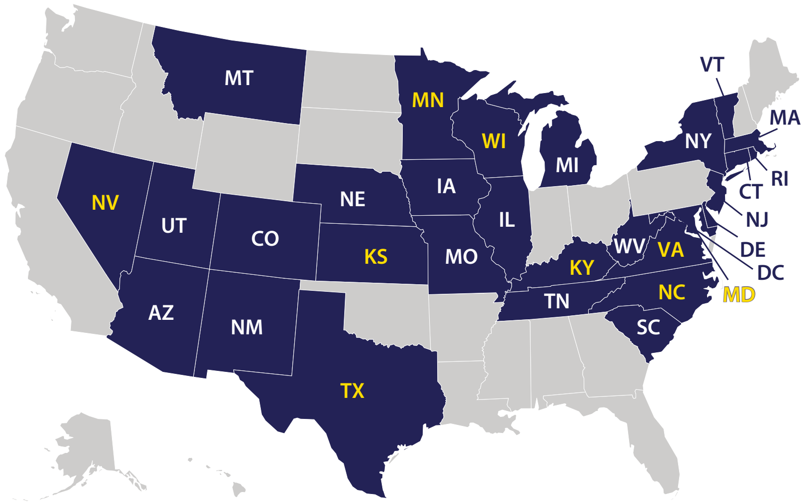
State debt-offset program: A national best practice

Debt-offset programs help states recover delinquent debt by intercepting payments the state makes to businesses. These programs use unique identifiers, such as federal taxpayer identification numbers (TINs), to compare businesses who owe debt to the state with those claiming payments. The program then helps a state recover the debt by reducing the amount paid by the amount owed.

In a survey of states conducted by the National Association of State Auditors, Comptrollers and Treasurers (NASACT) and the consulting firm CGI, other states reported that a debt-offset program is their most effective strategy for collecting debt. At least 29 states and the District of Columbia use debt-offset programs to recover debt owed by businesses, and 40 states use the program to collect debt owed by individuals. We talked to nine of these states and reviewed literature on debt collection. We learned that effective offset programs are automated with wide participation across agencies providing states with benefits such as: fast collections, increased voluntary compliance, recovery of difficult debts, and efficient use of agency's staff resources.

29 states use a debt-offset program to collect business debt

We interviewed nine of them, highlighted in yellow on the map.



Source: State Auditor's Office research.

Washington does not have a comprehensive debt-offset program

As of June 2014, businesses owed five state agencies about $738 million in outstanding delinquent debt that is more than 90 days past due. Individually, agencies actively pursue debt owed by businesses. They use a variety of collection tools to recover debt including notices to withhold and deliver, garnishments and levies. Several agencies included in our audit have the authority to offset payments internally as well as externally, by cooperating with other agencies. However, Washington lacks the single comprehensive legal authority needed to offset payments at a statewide level; it also lacks a systematic method to identify when delinquent businesses are receiving payments from the state. Currently, agencies can only detect payments the state makes to delinquent businesses by searching manually through each other's data systems – a process some agencies stated is time consuming.

Although some agencies use limited offset processes to collect debt internally before making payments to businesses, they do not offset debt businesses owe to all their divisions. Agencies included in the audit told us they believe a debt-offset program would be a beneficial additional tool in their debt-collection toolkit.

Audit objectives

This performance audit examined whether implementing a state debt-offset program and participating in the U.S. Treasury's State Reciprocal Program can help Washington collect delinquent business debt. The audit also identified leading practices other states recommend for developing and implementing effective debt-offset programs, and the changes Washington needs to make to put the programs into action.

Two debt-offset programs: two effective ways to help Washington collect delinquent debt

States typically have two options when they set out to recover delinquent business debt with a debt-offset program: a state-only program or a state program working in partnership with the U.S. Treasury's State Reciprocal Program. While a state offset program is not required to participate in the federal State Reciprocal Program, we learned that having the state program in place aids implementation of the federal program. The U.S. Treasury also prefers that a state's participation in its State Reciprocal Program be a consolidated effort to recover debt.

A state debt-offset program could have helped Washington more quickly recover about $4 million in delinquent business debt in one month

We compared the outstanding delinquent debt that businesses incurred and still owed to five state agencies in fiscal year 2013 to the payments eight state agencies made to those businesses in June 2013. We found agencies paid $261 million to businesses that, at the end of fiscal year 2013, still owed the state about $40 million in delinquent state and unemployment taxes, workers compensation premiums, and medical and social services debt. We estimate that, if the program had been in place, it could have potentially recovered about $4 million (10 percent) of this debt in one month.

It is likely agencies recovered some of the $4 million after June 2013 (the month of our estimate) with existing collection efforts. However, based on our test and benefits reported by other states, we concluded that a debt-offset program could have recovered these funds sooner, freeing up agency staff time to collect other types of debt that cannot be offset.

Several factors can affect an estimate of potential collections with a debt-offset program. Thus, future collections will vary: the amounts of debt owed and collected, as well as the amount the state pays businesses, can change daily or monthly. In addition, agency managers told us that some of the debt is being paid in installments under a payment plan while other debts may be under appeal.

Accurate and complete taxpayer data is key to maximizing collections with a debt-offset program

Other states find the success of an offset program depends greatly on the accuracy and completeness of taxpayer information. We learned that because of a lack of statutory authority to require federal taxpayer identification numbers (TINs), not all agencies track them. About $29 million (14 percent) of the total outstanding delinquent debt we reviewed lacked or had inaccurate TINs. As a result, we could not estimate all debt a state debt-offset program might have recovered for Washington in June 2013.

Quicker debt collections for the state with a state offset program

$4 million

Washington's estimated debt recovery in June 2013, using a state debt offset program based on leading practices

Washington could also benefit from participation in the U.S. Treasury's State Reciprocal Program

Four of the nine states we talked with participate in the federal program and said it was beneficial. Debt offset collections in those states ranged from $1 million to $8.7 million in 2013. These states also said the federal program helps with recovery of difficult debts, such as debt owed by out-of-state businesses and debt that is up to 10 years old.

To maximize collections through the federal program, Washington would have to remove a statutory barrier to data sharing as well as improve the accuracy of taxpayer data. According to staff at the Department of Revenue, state law (RCW 82.32.330) does not provide clear authority to share data with the U.S. Treasury.

Other states found benefits in participating in the federal reciprocal debt offset program

Debt offset collections for four states ranged

from $1 million to $8.7 million

in 2013

Leading practices could help guide the development and implementation of effective debt-offset programs

Our interviews with nine states that operate offset programs helped us identify several leading practices that could guide policy-makers and agencies to develop and implement effective debt-offset programs for Washington. The box to the right lists these practices.

Washington would need to make some changes to implement effective debt-offset programs

States we spoke with recommend establishing the program through legislation that includes key components such as identifying a lead agency, setting up a priority payment system and establishing a sustainable funding model. Implementing the program will also require process changes and system upgrades. The lead agency would have to modify its computer system to receive debt from other agencies, send notifications and conduct other offset activities. Additionally, some agencies would need to revise processes and systems to send their debt to and process payments through the lead agency. We learned that these functions could likely be integrated into the state's existing financial management system with modifications.

Other states report investments in system upgrades as the major expense when launching a debt-offset program. Although we did not conduct a cost estimate for Washington, states report that the investment is worthwhile because the benefits the program provides outweigh its costs.

Leading practices for developing and implementing effective debt-offset programs

- Select a lead agency to implement and administer the programs
- Maximize agency participation to increase collections
- Develop a sustainable funding model to finance the program's ongoing administrative costs
- Specify types of debt and payments the program can and cannot offset
- Establish a priority system to determine which types of debts are recovered first
- Provide due process to debtors to ensure they are treated fairly
- Authorize agencies to share confidential data needed for debt recovery
- Develop processes that are clear and standardized and automate them as much as possible
- Provide initial and ongoing training to staff at both the lead and the participating agencies

Recommendations

To implement effective debt-offset programs, we recommend:

1. The Legislature authorize state agencies to require federal TINs and share payment and debt data for the purposes of conducting state and federal debt offsets, allowing individual agencies to immediately enhance existing collection efforts.
2. The legislature authorize state agencies to participate in the U.S. Treasury's State Reciprocal Program.
3. The Legislature establish a workgroup with a directive to develop a proposal for the design and implementation of a state and the federal reciprocal debt-offset programs. To efficiently and effectively implement and administer the programs, the workgroup should:
    - Design the programs using the leading practices recommended by other states and the U.S. Treasury's State Reciprocal Program requirements
    - Identify ways for agencies to obtain accurate federal TINs
    - Identify necessary process changes and system upgrades
    - Estimate necessary resources
    - Identify statutory changes
    - Report its progress to the Legislature and the Governor's Office by June 30, 2016
4. Taking into account the workgroup's June 2016 report, the Legislature authorize a single comprehensive statute to offset debts owed by businesses with payments to those businesses.

Glossary

Agency Financial Reporting System (AFRS) The state-owned accounting system used by Washington agencies and higher education institutions. It performs all aspects of the accounting process: general ledger, accounts receivable, accounts payable, balance sheets, etc. Accounting information is updated daily by most users of the system.

Business An employer, provider, vendor, contractor, or tradesperson who does business with or has an obligation with the state or federal government.

Claimant agency A state agency that is owed debt and submits delinquent debt for collection through a debt-offset program.

Debtor An individual or business that owes debt to the state or federal government. This audit focused only on business debtors.

Delinquent debt A debt is delinquent when a debtor has failed to pay it after the due date established by an entity.

Involuntary collection actions Legal collection actions agencies use to recover money owed by businesses or individuals who failed to pay their debt voluntarily. Examples of these include notice to withhold and deliver, levies, garnishments and liens.

Lead agency The state agency that implements and administers debt-offset programs. The lead agency is in charge of, among other things, gathering the debt the state wishes to collect and matching debt against payments the state has authorized to recover debt.

Offset match When the debt-offset program identifies debts owed by and payments made to the same business using unique identifiers such as a federal taxpayer identification number. These offset matches are potential collections.

Payee An individual or business receiving payment from the state or federal government. This audit focused only on business payees.

State debt-offset program A state government debt collection program that compares pending payments to outstanding delinquent debts. When the program identifies a match between the recipient of a payment and the holder of a debt, the program recovers the debt by reducing the amount paid by the amount owed.

State Reciprocal Program (SRP) An offset program administered by the U.S. Department of the Treasury, Bureau of the Fiscal Services that helps states recover delinquent debt by offsetting federal vendor payments. In return, states offset payments to businesses who owe the federal government money.

Taxpayer Identification Number (TIN) A unique 9-digit number assigned by the federal government to businesses and individuals for the administration of tax laws. The Internal Revenue Service uses this number to verify that amounts businesses and individuals report on tax returns match those reported by the entities that paid them money. Depending on the business's structure and whether the business has employees, a TIN for a business could be either of the following:

- Federal Employer Identification Number (FEIN), assigned by the Internal Revenue Service.
- Social Security Number (SSN), assigned by the Social Security Administration.

Introduction

As of June 2014, businesses owed five state agencies about $738 million in outstanding delinquent debt that is over 90 days past due. Like many states, Washington state agencies pay businesses that owe debt to the state. A debt-offset program could help Washington recover delinquent debt by intercepting payments the state makes to businesses.

Debt-offset programs could offer significant benefits

Our research and interviews suggest that effective debt-offset programs can bring significant benefits to the states that operate them, such as:

- **Expanded collection capabilities** A comprehensive and automated offset process can routinely compare debts to payments within and across all participating agencies.
- **Efficient use of staff resources** An automated offset process can be less time consuming than manual collection procedures, leaving agency staff more time to concentrate on collecting other types of debt.
- **Fast collections** Agencies should have fair but aggressive programs to recover delinquent debt. Routine, automated matching of debts and payments can collect debt faster than manual processes. Faster debt collections generally yield more revenue since the ability of an agency to collect its delinquent debts diminishes over time.
- **Increased voluntary compliance** Some states report that debtors voluntarily pay their debts more frequently as a result of the offset program because debtors realize the state is serious about collecting debt and want to avoid disruption in services and additional collection fees.
- **Recovery of difficult debts** Debt-offset programs can help states recover debt that agencies may have had to write-off or declare uncollectable due to challenges in identifying when the government makes payments to delinquent businesses.
- **Better management of debt data** Other states report that debt-offset programs encourage state agencies to improve the completeness and accuracy of taxpayer data, which in turn improves other collection processes.

Kentucky said that after the first year of offsetting payments from Medicaid providers, many came into compliance and voluntarily paid their debt.

Washington does not have a comprehensive state debt-offset program, nor does it participate in the U.S. Treasury's State Reciprocal Program

Individually, state agencies actively pursue delinquent debt owed by businesses, employing a variety of collection tools to recover debt. The Department of Revenue, for example, uses a tool called "e-withhold," to recover tax debt directly from a taxpayer's financial institution. The Department of Labor and Industries and the Health Care Authority offset medical provider debt internally from future payments to those providers. However, Washington lacks the single comprehensive legal authority needed to offset payments at a statewide level; it also lacks a systematic method to identify when delinquent businesses are receiving payments from the state.

In addition, Washington does not participate in the U.S. Treasury's State Reciprocal Program. This program helps states recover delinquent business debt by offsetting federal vendor payments. In return, states offset payments to businesses who owe the federal government money. Treasury implemented this program in 2008. Currently, seven states and the District of Columbia participate in the program.

Wisconsin said it collected debt owed by out-of-state businesses through the U.S. Treasury's State Reciprocal Program. This is money the state thinks it would have never been able to recover through other processes.

Audit Scope and Methodology

We designed this audit to answer three questions:

1. Can a state debt-offset program help Washington collect delinquent business debt?
2. Can participation in the U.S Treasury's State Reciprocal Program help Washington collect delinquent business debt?
3. What actions would Washington need to take to develop and implement effective debt-offset programs?

Estimating potential debt collections with a state debt-offset program

Although a state debt-offset program can also be used to collect debt owed by individuals, this audit focused on debt owed by businesses. To estimate the amount of delinquent debt a state debt-offset program might have been able to recover for Washington in one month we performed these procedures:

State agencies in audit scope	Included in state offset program estimate	Included in federal offset program estimate
Employment Security	✔	✔
Enterprise Services	✔	
Health Care Authority	✔	✔
Labor & Industries	✔	✔
Lottery	✔	
Revenue	✔	
Social & Health Services	✔	✔
Transportation	✔	

- We calculated the amount of outstanding delinquent debt that businesses incurred with five agencies in fiscal year 2013 and which they still owed at the end of the same fiscal year. We then used federal TINs to compare this amount to payments eight agencies made to businesses in June 2013. Although additional agencies are owed business debt and make payments to businesses, we selected five agencies with the largest business debt balances and eight agencies making substantial payments to businesses. See **Appendix B** for more information about the agencies that provided debt and payment data for analysis.
- When we identified matches between businesses that owed debt and those receiving payments, we calculated the amount a state debt-offset program could have collected in June 2013. An offset program can only offset a payment up to the full amount of the debt owed. Therefore, if payments were greater than the debt, the offset amount was equal to the debt. If payments were less than the debt, the offset amount was equal to the payment.

Estimating potential debt collections with participation in the U.S. Treasury's State Reciprocal Program

To estimate the amount of potential collections if Washington participated in the federal State Reciprocal program, we asked the U.S. Treasury to match a portion of the outstanding delinquent debt businesses owed to four state agencies against one month of federal vendor payments. The U.S. Treasury's current testing environment can only compare one month of federal vendor payments against outstanding state debt. Although initial results were available, Treasury officials indicated in November 2014 that they needed to make revisions to their estimates. The revised results are expected early in 2015.

Identifying leading practices and lessons learned in other states

We first reviewed debt offset laws nationwide to find states that have authority to operate an offset program to collect business debt. To gain an understanding of leading practices and lessons learned, and how states designed and manage their offset programs, we selected nine states for review. We based our selection on factors such as tax structures, agency participation requirements, level of centralization in debt collection, and funding models.

Our conversations with offset program staff and management in these states helped us understand the legislative, system and process changes needed to implement and administer effective debt-offset programs. **Appendix C** provides more details of offset programs in the nine states we interviewed.

States interviewed	Has a state business debt offset program	Participates in U.S. Treasury's State Reciprocal Offset Program
Kansas	✔	
Kentucky	✔	✔
Maryland	✔	✔
Minnesota	✔	✔
Nevada	✔	
North Carolina	✔	
Texas	✔	
Virginia	✔	
Wisconsin	✔	✔

Identifying changes Washington would need to consider

To identify additional changes Washington needs to make to implement effective debt-offset programs, we reviewed relevant Washington laws and interviewed state agencies to gain an understanding of the capabilities and limitations of existing collection tools, processes and systems.

Appendix D provides more details on system and process changes needed to implement effective debt-offset programs. **Appendix E** provides a checklist of the minimum legal requirements Washington would need to meet to participate in the U.S. Treasury's State Reciprocal Program.

Audit performed to standards

We conducted this performance audit under the authority of state law (RCW 43.09.470), approved as Initiative 900 by Washington voters in 2005, and in accordance with Generally Accepted Government Auditing standards (December 2011 revision) issued by the U.S. Government Accountability Office. 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. See **Appendix A**, which addresses the I-900 areas covered in the audit. **Appendix B** contains more information about our methodology.

Next steps

Our performance audits of state programs and services are reviewed by the Joint Legislative Audit and Review Committee (JLARC) and/or by other legislative committees whose members wish to consider findings and recommendations on specific topics. Representatives of the State Auditor's Office will review this audit with JLARC's Initiative 900 Subcommittee in Olympia. The public will have the opportunity to comment at this hearing. Please check the JLARC website for the exact date, time, and location (**www.leg.wa.gov/JLARC**). The State Auditor's Office conducts periodic follow-up evaluations to assess the status of recommendations and may conduct follow-up audits at its discretion.

Audit Results

Question 1: Can a state debt-offset program help Washington collect delinquent business debt?

A state debt-offset program could have helped Washington more quickly recover about $4 million in delinquent business debt in one month.

Our analysis found that in June 2013 state agencies paid $261 million to businesses that, at end of fiscal year 2013, still owed the state about $40 million in delinquent taxes, workers compensation premiums, and medical and social services debt. We estimate that, if a state debt-offset program had been in place, it could have potentially recovered about $4 million (10 percent) of this debt in one month. The program could have used state and unemployment tax refunds, payments for products and services, unclaimed property and lottery winnings to recover the debt.

It is likely agencies recovered some of the $4 million after June 2013 (the month of our estimate) with existing collection efforts. However, based on our test and benefits reported by other states, we concluded that a debt-offset program could have collected these funds sooner, freeing up agency staff time to recover other types of debt that cannot be offset.

Quicker debt collections for the state with a state offset program

$4 million

Washington's estimated debt recovery in June 2013, using a state debt offset program based on leading practices

Not all $40 million in outstanding delinquent debt could have been recovered in one month because some of the businesses that owed a significant portion of this debt did not receive sufficient payments in June 2013 to offset all their debt this month.

Several factors can affect an estimate of potential collections with a debt-offset program. Thus, future collections will vary: the amounts of debt owed and collected, as well as the amount the state pays businesses, can change daily and monthly. In addition, agency managers told us that some of the debt is being paid in installments under a payment plan while other debts may be under appeal. The amount the state can recover once the program is implemented will also be affected by policy decisions such as how many agencies participate in the program and the types of debts and payments the state authorizes for offset. In Question 3 in this report, we offer leading practices that can help guide policy-makers and agencies as they consider implementing effective debt-offset programs for Washington.

Additional considerations are the legal restrictions on how some debt recovered through a debt-offset program can be used. For example, some debt recoveries, such as unemployment taxes and worker's compensation premiums, are earmarked to go into federal and state trust funds. And a portion of the money collected on medical and social services debt that has a federal component must be returned to the federal government.

Accurate and complete taxpayer data is key to maximizing collections with a debt-offset program.

Other states find the success of an offset program depends greatly on the accuracy and completeness of taxpayer data. States we spoke with use federal taxpayer identification numbers (TINs) to match debt businesses owe with payments the state makes to businesses. We also used federal TINs in our analysis to identify potential debt recoveries. We learned that because of a lack of statutory authority to require federal TINs from businesses, not all agencies track them.

About $29 million (14 percent) of the total outstanding delinquent debt businesses incurred and still owed to five state agencies at the end of fiscal 2013 lacked or had inaccurate TINs. As a result, we could not estimate all debt a state debt-offset program might have recovered for Washington in June 2013.

To improve taxpayer data and maximize collections with a debt-offset program, some states recommend that agencies ask for and verify the accuracy of taxpayer information during the business registration or enrollment process. Doing so increases the likelihood of debt recovery later on because businesses are more likely to provide complete and correct data when they do not owe money.

Question 2: Can participation in the U.S. Treasury's State Reciprocal Program help Washington collect delinquent business debt?

We found Washington could benefit from participating in the federal program

Four states we talked with participate in the U.S. Treasury's State Reciprocal Program and found it beneficial. Debt offset collections in those states ranged from $1 million to $8.7 million in 2013.

States we interviewed report implementation costs to participate in the federal State Reciprocal Program are relatively low and can be recovered quickly. For example, Maryland said it spent about $600,000 to implement the program. The state has recovered more than $67 million since joining the program in 2008. Currently, Treasury charges states a flat fee of $15 for every offset done for states to finance the program's ongoing administrative costs. Some states we talked with pass this fee onto the delinquent business.

The federal program can help states recover difficult debts. Some states we spoke to said this program has helped them recover more debt owed by out-of-state businesses than they could have recovered with other collection tools. Many delinquent out-of-state businesses do not have property or receive payments in the state where the debt was established. This program provides a means for states to recover this debt through federal payments. Moreover, when a state joins this program, the U.S. Treasury allows the use of federal vendor payments, in addition to federal tax payments, to recover a state's unemployment benefit debt. States can also collect some debt considered uncollectable and not usually targeted by agencies because the program recovers debt that is up to 10 years old.

Washington could maximize collections with the federal program by collecting complete and accurate taxpayer information and removing a statutory barrier to data sharing

The federal program only offsets debt when the state's delinquent business's federal TIN and name match the federal TIN and name of a business paid by the federal government. In an initial review of taxpayer debt data from Washington, Treasury indicated that, although the TINs of a significant number of businesses matched the TINs of businesses that receive federal payments, their names did not match. Treasury told us that common causes for name discrepancies include spelling errors and inconsistent data entry.

Other states found benefits in participating in the federal reciprocal debt offset program

Debt offset collections for four states ranged

from $1 million to $8.7 million

in 2013

To help states solve these cases and improve collections through this program, Treasury provides states a report with debts that matched federal payments by TIN, but not by business name. If Washington implements this program, agencies could use this list to research the discrepancies and determine if the names belong to the same business.

Moreover, according to staff at Washington's Department of Revenue, state law (RCW 82.32.330) does not provide clear authority to share tax data with the U.S. Treasury. Given that this agency accounts for a significant portion of the delinquent debt owed to the state, including its debt in the program most likely would result in the collection of more debt.

Question 3: What actions would Washington need to take to develop and implement effective debt-offset programs?

We interviewed nine states that use their offset programs to collect delinquent business debt. Most of these states have had their offset programs for many years. As in Washington, some of these states do not collect income taxes, and some do not have centralized debt collections. Although the amounts these states collect with their offset program vary widely, they find the program beneficial and use it as an additional tool to enhance their state's debt collection processes and capabilities. The successes and challenges of these states helped us identify leading practices that could guide policy-makers and agencies as they consider a debt-offset program for Washington.

To develop and implement effective debt-offset programs, these states recommend:

- Pass legislation that includes key components.
- Develop processes that are clear and standardized and automate them as much as possible.
- Provide initial and ongoing training to staff at both, the lead and the participating agencies.

Specific aspects of each group of leading practices are discussed below. **Appendix C** provides more information about debt-offset programs in the nine states we interviewed. Page 18 provides information about enabling the U.S. Treasury's State Reciprocal Program.

Pass legislation that includes key components

All the states we spoke with passed legislation to create their offset programs. They emphasized the importance of incorporating all necessary program components, listed below, in the statute to maximize the program's benefits and facilitate administration.

1. Select a **lead agency** to implement and administer the programs.
2. Maximize **agency participation** to increase collections.
3. Develop a sustainable **funding model** to finance the programs' ongoing administrative costs.
4. Specify **types of debts and payments** the program can and cannot offset.
5. Establish a **priority system** to determine which types of debts are recovered first.
6. Provide **due process** to debtors to ensure they are treated fairly.
7. Authorize agencies to **share confidential data** needed for debt recovery.

In the pages that follow, we examine these program components in more detail.

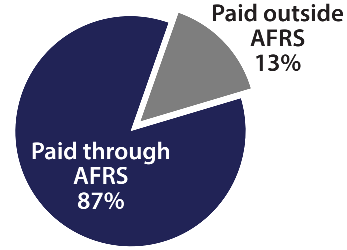
1. Select a lead agency to implement and administer the program

To effectively recover debt, Washington will need to select a lead agency to implement and administer the offset programs. The lead agency will be responsible for, among other things, gathering the debt the state wants to collect and matching it against payments the state has authorized for use in debt collection. Offset program officials in some states said that fewer system upgrades and process changes are needed if a state selects either its central debt collection agency and/or its central payment agency to lead the offset program.

As is the case in some of the states we interviewed, Washington does not have a central debt collection agency, but it does have a central payment agency in the Department of Enterprise Services, making it a good candidate to lead the program. As shown in **Exhibit 1**, in June 2013 Enterprise Services processed 87 percent of the payments eight agencies made to delinquent businesses through the Agency Financial Reporting System (AFRS). And some state agencies' debt collection systems can already send data to this payment system.

Exhibit 1 - Proportion of business payments paid through AFRS

Represents results for payments eight state agencies made to delinquent businesses in June 2013



Source: State Auditor's Office analysis of payment data.

2. Maximize agency participation to increase collections

Two types of state agencies are particularly important to the success of a debt offset program: those with large delinquent debt balances and those making substantial payments to businesses. Six of the nine states we spoke with mandate agency participation in the debt-offset program and believe this is an effective way to maximize participation. Some states with voluntary participation said a voluntary program helps agencies "buy in." However, they also said they had to devote considerable resources to initial outreach in an effort to persuade agencies to participate; their early collections results were lower than in the later years.

3. Develop a sustainable funding model to finance the program's ongoing administrative costs

Administering a debt-offset program involves ongoing costs, including staffing, training, correspondence, telephone services, and computer system maintenance and enhancements. But offset program officials find the benefits the program provides outweigh its costs. Five of the nine states we spoke with pay for the program's entire ongoing costs through fees charged to debtors. These fees are typically set as a percentage of the amount collected and range from 15 percent to 25 percent. Kansas charges state agencies fees but is considering switching to a business-based fee. Two states, Virginia and Texas, are able to finance program operations through existing resources that are part of other debt collection efforts.

4. Specify types of debts and payments the program can and cannot offset

Clarifying which debts and payments are included and excluded from offset can help protect the state from litigation brought by businesses that disagree with the use of their payments to recover money they owe to the state. Offset program officials explained that the decision to exclude certain debts and payments is usually based on existing federal or state restrictions or a state's policy decisions. **Exhibit 2** lists some examples of business debts and payments a few states include and exclude from offset.

North Carolina's offset program consulted with participating agencies and researched state and federal statutes to determine which debts and payments should be used in its offset program.

Exhibit 2 - Examples of business debts and payments some states include and exclude from offset

Business debts included: • Tax debt • Most other debt businesses owe to state agencies	**Business debts excluded:** • Debt that has been dismissed in bankruptcy • Debt being managed through an active payment plan
Business payments included: • State tax refunds • Payments a business receives for goods and services supplied to state or on behalf of the state	**Business payments excluded:** • A few states exclude some payments funded with federal dollars

5. Establish a priority system to determine which types of debts are recovered first

Establishing a priority system in legislation helps prevent strained relationships between the offset program and participating agencies. Program officials said this is of particular importance when a business owes debts to multiple agencies and the payments the business will receive are not sufficient to offset all debts. Many of the states we interviewed give first priority for collections to delinquent state taxes. Priorities for collecting other types of business debts include:

- **First-come, first-served.** This method recovers debt based on the date agencies submit the debt to the offset program. Agencies that send their debt to the program first get priority over others for collections. This practice encourages agencies to submit accurate debt data to the lead agency promptly.
- **Debt size.** This method collects debt based on the amount of the debt. Agencies that send large debts get first priority over collections.
- **Date agency registered with the program.** In offset programs with voluntary participation, this method encourages agencies to participate early on.

Virginia said a first-come, first-served approach encourages state agencies to submit accurate information the first time, in the correct format and in a timely manner.

North Carolina said that in an offset program with voluntary participation, basing priority on date of registration can encourage agencies to participate in the program early on.

6. Provide due process to debtors to ensure they are treated fairly

While states we interviewed strive to collect the maximum amount of money possible, they also recognized the need for debtors to be treated fairly. Their offset program legislation required that agencies give delinquent businesses minimum due process before and during offset procedures. **Exhibit 3** sets out examples of due process in other states.

Exhibit 3 - Other states' debt-offset programs offer basic due process to debtors

Opportunities to pay debt prior to referring it to offset program	• Some states require that agencies attempt to collect debt before referring it to the offset program. • Some states require that debt be anywhere from 60 to 90 days delinquent or that agencies make three unsuccessful attempts to collect the debt before referring it to the offset program.
Notice	• Some states require that the offset program and/or agencies notify debtors when the program has identified a payment that will be used to offset the debt. • Some states encourage agencies to inform businesses in advance that if they fail to pay their debt, it will be referred to the offset program for collection and they will have to pay the money owed plus an additional recovery fee.
Appeal rights	• Some states require agencies to provide debtors an opportunity to contest the offset, typically 30 days from the date of the notice.

7. Authorize agencies to share confidential data needed for debt recovery

Offset program officials said it is critical to eliminate restrictions that prevent the lead agency and participating agencies from sharing confidential data. Maryland's statutes restrict the sharing of tax data, so the daily management of its offset program had to be split between two entities, creating inefficiencies. Virginia's offset program does have statutory authority to share debt data with key agencies, facilitating operations while maximizing collections.

Washington state agencies included in our review are currently allowed to share confidential payment data with Enterprise Services, but they would need authorization to share their delinquent debt with Enterprise Services if it is selected to lead the program.

Develop processes that are clear and standardized, and automate them as much as possible

In addition to the statutory elements described above, other states said automated, clear and standardized processes are key to operating a successful debt-offset program. The lead agency needs to develop three main areas in collaboration with participating agencies: the management of delinquent debt data, a process for identifying offsets, and protocols for communicating with claimant agencies and businesses. We learned these functions could likely be integrated into the state's existing financial management system with modifications.

- **Transmit, receive and store debt files.** The debt-offset program should establish a process for agencies to send debts to the lead agency and update those accounts as payments, adjustments, penalties and interests occur. The lead agency will need to develop processes and rules for sending debt files to and receiving debt files from agencies that will address the different debt collection systems currently in place.
- **Identify potential offsets.** The debt-offset program needs a method to match outstanding debts against pending payments to determine whether an offset can take place. To ensure the accuracy of matches, some states we spoke with use federal TINs in combination with a second identifier, such as the debtors' name, to match debts with payments.
- **Communicate with claimant agencies and businesses.** The debt-offset program needs to establish communication protocols so both, the business and the claimant agency are notified promptly of the potential offset. Program officials recommend that agencies verify the debt amount is still accurate and legally due. Businesses must also be notified to provide them with an opportunity to contest the offset. Offset programs in other states have established expectations for effective communication to ensure all parties are kept informed and responsive.

These types of repetitive tasks and processes lend themselves to automation within computerized systems and applications. Offset program officials told us that automating offset processes can greatly improve the efficiency and effectiveness of the program. Automation can help reduce errors, ensure the program aligns with laws and rules, and reduce the amount of staff time and resources required for program administration. Because it would be expensive to replace all the related technology, Washington should consider incorporating the new automated offset processes into existing computer systems and debt collection procedures as much as possible. **Appendix D** provides more details on system and process changes needed.

Provide initial and ongoing training to participating agencies

Training is essential for the effective administration of a debt-offset program, especially in the earliest phases so relevant employees at the lead and participating agencies understand how the process works. Even with an automated offset program, people still have a key role in keeping the program operating smoothly. For example, agencies will need staff to format debt files properly, to keep debt balances current to ensure that offsets are accurate, and for customer service calls. Offset program officials said that ongoing training is also important because of staff turnover.

Employees in participating agencies will need training so they can communicate effectively with the lead agency and debtors. Offset program officials said they rely on agencies' employees to solve issues that arise during the daily administration of the program and to give businesses information about the debt that is being offset. If agencies fail to respond to questions, businesses approach the offset program for answers.

However, program officials do not recommend that the lead agency be responsible for answering customer service questions about the debt because they are not experts in the debt and the overall volume of calls for the program can be burdensome. The burden is lessened and operational efficiency improves when each participating agency fields its own calls about debts.

Actions needed to implement the U.S. Treasury's State Reciprocal Program

Through interviews with the U.S. Treasury and four states (Kentucky, Maryland, Minnesota and Wisconsin) that currently participate in the U.S. Treasury's State Reciprocal Program, we learned that Washington would need to address two key issues in order to participate in this program:

1. Pass legislation authorizing participation in the U.S. Treasury's State Reciprocal Program
2. Consider implementing the state debt-offset program first

1. Pass legislation authorizing participation in the U.S. Treasury's Reciprocal Program

Legislation would authorize the state to enter into a reciprocal debt collection agreement with the U.S. Treasury. Treasury reports that such an agreement must provide the state, at a minimum, with:

1. Authority to offset state tax refunds and other business payments to help recover federal debt.
2. Authority to submit the state's delinquent debt to the U.S. Treasury. The U.S. Treasury prefers that a state's participation in its federal reciprocal program be a consolidated effort.
3. Authority for the U.S. Treasury to charge a fee to the state to cover its cost of running the program. The current fee charged to states is $15 for every offset. States are free to add that fee to the debt balance, if state law authorizes it. Some states also incorporate into their legislation permission for the state to charge the payee for the offset of their payment to recover federal debt.
4. Due process for debtors in accordance with the agreement and federal code 31 CFR 285.6.
5. No authority for the state to charge fees to U.S. Treasury for collecting federal debt.

Appendix E provides more details on minimum legislative requirements to participate in the U.S. Treasury's State Reciprocal Program.

2. Consider implementing the state debt-offset program first

Some states we spoke with found that having their state debt-offset program in place aided implementation of the U.S. Treasury's State Reciprocal Program for the following reasons:

- The lead agency of their state's offset program already had a system that was collecting delinquent debt through offsets for state agencies. This created one point of contact between the state and the U.S. Treasury to share delinquent state debt for offset with federal payments; also to offset state payments to recover federal debt.
- The investments in system upgrades are less because the state only had to change the lead agency's system to communicate with the U.S. Treasury instead of upgrading all state agencies' debt and payment systems to perform this function.

Putting effective debt-offset programs in place requires significant changes, but other states said the rewards outweigh the effort

Our analysis and the experiences of other states indicate that state and federal debt-offset programs can help Washington recover delinquent debt. But developing and implementing the programs would require legislation and dedicated staff to develop offset processes and rules and update existing systems and processes to incorporate the new program. This effort will require some initial investment.

Although we did not conduct a cost estimate for Washington, other states find the investment in offset programs is worthwhile because the benefits the programs provide outweighed their costs. Some states have financed the program's startup costs one of two ways, through a legislative allocation or prepayment and amortization. Under prepayment, the lead agency could prepay for the costs of systems upgrades and recover those costs over time through fees.

Washington is currently in the planning phase of developing a modern financial management system. The state plans to include debt offset functionality in this new system. If a debt offset function is incorporated, the state could consider this system as another option to aid in the implementation and administration of effective state and federal reciprocal offset programs.

However, a new financial management system is not necessary to implement the programs. Based on interviews with staff at Enterprise Services, the state's existing financial management system could likely be modified to implement the programs. We also spoke with some states that, like Washington, do not currently have centralized debt collection systems and some that did not have them when they implemented their offset programs. We learned these states adapted their debt-offset programs to suit their capabilities and needs by incorporating the programs into existing systems and processes and making improvements over time.

Recommendations

To implement effective debt-offset programs, we recommend:

1. The Legislature authorize state agencies to require federal TINs and share payment and debt data for the purposes of conducting state and federal debt offsets, allowing individual agencies to immediately enhance existing collection efforts.
2. The Legislature authorize state agencies to participate in the U.S. Treasury's State Reciprocal Program.
3. The Legislature establish a workgroup with a directive to develop a proposal for the design and implementation of a state and the federal reciprocal debt-offset programs. To efficiently and effectively implement and administer the programs, the workgroup should:
   - Design the programs using the leading practices recommended by other states and the U.S. Treasury's State Reciprocal Program requirements
   - Identify ways for agencies to obtain accurate federal TINs
   - Identify necessary process changes and system upgrades
   - Estimate necessary resources
   - Identify statutory changes
   - Report its progress to the Legislature and the Governor's Office by June 30, 2016
4. Taking into account the workgroup's June 2016 report, the Legislature authorize a single comprehensive statute to offset debts owed by businesses with payments to those businesses

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November 21, 2014

The Honorable Troy Kelley
Washington State Auditor
P.O. Box 40021
Olympia, WA 98504-0021

Dear Auditor Kelley:

On behalf of the audited agencies, thank you for the opportunity to review and respond to the State Auditor's Office (SAO) performance audit report, *"Debt-Offset Programs: A tool to help Washington collect delinquent debt."* To provide this consolidated response, the Office of Financial Management worked with the Health Care Authority and Lottery, and the departments of Employment Security, Enterprise Services, Labor and Industries, Revenue, Social and Health Services, and Transportation.

The report highlights opportunities for Washington to potentially collect debt sooner by implementing a comprehensive automated debt-offset program. We appreciate the information the SAO collected from other states. While Washington is unique in many ways, including its tax structure, it is helpful to see common practices among the nine states interviewed. We agree cross-agency debt-offsets could complement existing debt collection tools and help rein in the underground economy – those individuals and businesses that conceal their true tax liability to government.

We support the SAO's recommendation for further study before deciding to implement a comprehensive debt-offset process. None of the states the SAO interviewed could provide a cost estimate for establishing a comprehensive system. The performance audit did not examine how much sooner this kind of program would collect debt as compared to practices now in place. While there is potential to collect debt sooner and improve cash flow, it is not *new* revenue, and it is unknown how long it would take to amortize any investment.

While we agree that a comprehensive debt-offset program merits further exploration, the costs to implement a system that addresses the complexities of Washington's unique tax structure and potential impacts to our business-friendly climate are still unknown. It is a complex topic with potential for significant unintended consequences and costs.

State agencies that participated in the audit currently have strong debt collection practices that include some debt-offset strategies, both in their agencies and among other state, local and federal jurisdictions. Some Washington State agencies already participate in the U.S. Treasury's Offset Program (TOP). TOP reported that Washington State recovered $51.1 million in fiscal year 2013 by participating in three of the five Treasury offset programs. For examples of additional debt-offset practices, please see Attachment A.

Strategies and efforts need to align with enterprise projects in progress. For example, efforts are underway to develop a new statewide financial reporting system. Washington recently completed the planning and strategy phase for this project, which, if funded, would include implementation of an enterprise resource planning system that includes debt-offset functionality. Regardless of whether changes are made to the current financial management system or to its replacement, we believe that implementing a comprehensive debt-offset program would require substantial resources and funding.

In addition, the performance audit did not reach out to the business community to learn about its challenges or potential concerns with a debt-offset program. Careful consideration must be given to how an automated cross-agency system may affect businesses and allow due process in any debt collection situation. Any decrease in due process could damage the business climate or drive away potential new businesses.

Washington businesses must have an opportunity to give input on the statutory, process and IT changes the SAO identified. In addition, input is needed on notification, due process and other changes that a comprehensive debt-collection process may require.

If the Legislature agrees to establish a work group to further analyze and propose the design and implementation of a comprehensive automated debt-offset program, the work group should be funded. The work group should consider the needs of the business community, collection best practices, and other enterprise efforts in its work. Once the costs and benefits are fully developed, the Legislature will have enough information to weigh building a new debt-offset system against other resources and priorities.

The Legislature might also consider allowing state agencies to individually enter into reciprocal agreements with the U.S. Treasury under TOP until a comprehensive state debt-offset program can be further studied.

We would like to note that the SAO looked at a broad population of business debt to demonstrate the potential of an automated offset system. Because the audit methodology did not analyze other debt collection efforts already in place, the SAO did not report on how much of the estimated collections would have been collected under current processes.

In addition, the SAO audit included debt from small businesses that provide vital services to citizens. There may be unintended consequences by including them in an automated offset program.

Other debt included in the audit analysis is being paid off through agreed-upon payment plans; this debt would also likely not be processed through a comprehensive debt-offset system. It is critical to identify the right types of business debt for the right reasons and ensure they have due process prior to an automatic offset. We believe manual checks to ensure the debt still exists would continue to be needed, as well as established policies and processes for appeals.

State agencies have at various times discussed comprehensive debt-offset efforts and see the potential benefits such a program may have. We appreciate the SAO drawing attention to this topic.

Sincerely,

David Schumacher
Director

cc: Joby Shimomura, Chief of Staff, Office of the Governor
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Joel Sacks, Director, Department of Labor and Industries
Bill Hanson, Director, Washington's Lottery
Carol Nelson, Director, Department of Revenue
Kevin Quigley, Secretary, Department of Social and Health Services
Lynn Peterson, Secretary, Department of Transportation

ATTACHMENT A – EXAMPLES OF CURRENT DEBT-OFFSET PRACTICES

	In Agency	Other State Agencies or Local Jurisdictions	Federal
Employment Security		• Interface with DOR credit system for debit balance on ESD account • Lottery winners – offset winnings against taxes owed (sole proprietors) • Manually issue withholds to offset credits at Labor and Industries • Vehicle or vessel lien interface with Department of Licensing • Manually issue withholds to offset credits at DOR • Public works retainage claims initiated with the Attorney General • Contractor bond packets submitted to the Attorney General, and the courts submit a letter to the surety company	Treasury Offset Program interface with Federal Management Services Bureau within the IRS to commence in January 2015 (sole proprietors and general partnerships)
Health Care Authority	Medicaid, medical and other selected payments are consolidated in the single provider payment system, ProviderOne, which automatically recoups overpayments by offsetting the debt against current payments due to providers		

1

Labor and Industries	• Offset provider overpayments against future payments to those providers • Offsets to employers for Stay at Work program for amounts owed to the agency, including taxes and unpaid wages owed to WA workers	• Lottery winners – offset winnings against claim overpayments owed (individuals) • Unclaimed property – offset unclaimed property against debt owed • Manually issue withholds to offset credits at DOR and ESD • Public works contracts – file a lien against the retainage bond	Federally funded transportation projects – levy contract bonds for federally funded transportation projects
Washington's Lottery		• Lottery winners (natural persons) of prizes greater than $600. Business debt may be withheld when business structure is a sole proprietorship. • No prize payment debt offset for vendor payments	
Social and Health Services	Offset payments to vendors currently providing services to DSHS	• Offset payments to vendors providing services to the Department of Early Learning and Health Care Authority • Offset WA Lottery winnings greater than $600	
Revenue	• Unclaimed property – offset unclaimed property against debt owed • DOR Credit System – offset debt against credits owed to a taxpayer	• Lottery winners – offset winnings against taxes owed (sole proprietor) • Public works contracts – file a lien against the retainage bond	Federally funded transportation projects – levy contract bonds for federally funded transportation projects

2

OFFICIAL STATE CABINET AGENCY RESPONSE TO THE PERFORMANCE AUDIT ON DEBT-OFFSET PROGRAMS: A TOOL TO HELP WASHINGTON COLLECT DELINQUENT DEBT – NOVEMBER 20, 2014

This coordinated management response to the State Auditor's Office (SAO) performance audit report received on November 5, 2014, is provided by the Office of Financial Management, Health Care Authority and Lottery, and the departments of Employment Security, Enterprise Services, Labor and Industries, Revenue, Social and Health Services, and Transportation.

SAO PERFORMANCE AUDIT OBJECTIVES:

The SAO sought to answer three questions:

1. Can a state debt-offset program help Washington collect delinquent business debt?
2. Can participation in the U.S. Treasury's State Reciprocal Program help Washington collect delinquent business debt?
3. What actions would Washington need to take to develop and implement effective debt-offset programs?

SAO Issue 1: A state debt-offset program could have helped Washington more quickly recover about $4 million in delinquent business debt in one month.

SAO Issue 2: Washington could have collected about $1.2 million in a single month through participation in the U.S. Treasury's State Reciprocal Program.

SAO Issue 3: Pass legislation that includes key components including: select a lead agency; maximize agency participation; develop a sustainable funding model; specify types of debts and payments the program can and cannot offset; establish a priority system for the types of debt that are recovered first; provide due process to debtors; authorize agencies to share confidential data.

SAO Recommendation 1: The Legislature authorize state agencies to collect federal TINs and share payment and debt data for the purposes of conducting state and federal debt offsets, allowing individual agencies to immediately enhance existing collection efforts.

STATE RESPONSE:

We agree with the SAO performance audit report that a single common identifier across agencies is key to an effective comprehensive debt-offset program. We support removing statutory barriers where they exist and where it makes sense.

Action Steps and Time Frame

- None applicable. *Directed to the Legislature*.

SAO Recommendation 2: The Legislature authorize state agencies to participate in the U.S. Treasury's State Reciprocal Program.

STATE RESPONSE:

We concur with the SAO recommendation to authorize and remove barriers for state agencies to participate in the U.S. Treasury's State Reciprocal Program. While the U.S. Treasury recently indicated it would be willing to work with individual agencies to establish reciprocal agreements, providing the authority to allow offsets of federal debts and state agency debts — as well as the authority to collect the necessary information and related offset fees — would help maximize participation by Washington State agencies.

Some Washington State agencies already participate in the U.S. Treasury's Offset Program (TOP). The U.S. Treasury reported that Washington State agencies recovered $51.1 million in fiscal year 2013 by participating in its programs. TOP state reciprocal program may help Washington recover debt owed to the state more quickly. However, it is important to note that the debt owed is not new money.

Action Steps and Time Frame

- None applicable. *Directed to the Legislature*.

SAO Recommendation 3: The Legislature establish a workgroup with a directive to develop a proposal for the design and implementation of a state and the federal reciprocal debt-offset programs. To efficiently and effectively implement and administer the programs, the workgroup should:

- Design the programs using the leading practices recommended by other states and the U.S. Treasury's State Reciprocal Program requirements
- Identify ways for agencies to obtain accurate federal TINS
- Identify necessary process changes and system upgrades
- Estimate necessary resources
- Identify statutory changes
- Report its progress to the Legislature and the Governor's Office by June 30, 2016

STATE RESPONSE:

We agree that more needs to be known about the costs, benefits and design of a comprehensive automated debt-offset system. We support the SAO's recommendation to the Legislature to establish a work group to further study and provide a proposal. None of the states the SAO interviewed were able to provide a cost estimate for establishing a comprehensive system. Nor did the performance audit examine how much sooner debt might be collected under this kind of program. While there is potential to collect debt sooner, it is not new revenue, and it is unknown how long it would take to amortize the investment. Additional research is still needed, and efforts need to be weighed against state resources and other statewide priorities.

Automated debt-offset between agencies is a complex topic with potential for significant unintended consequences and costs. Assuming the Legislature provides funding to establish a work group, we believe that in addition to the elements the SAO identified, careful consideration must be given to how an automated cross-agency system may affect businesses. The performance audit did not include input from the business community about potential impacts to Washington's business climate.

In addition to IT system and process changes, the work group should assess:

- Costs/benefits to implement, including cultural changes, communication and training requirements
- Impacts to businesses
- Types of debt feasible to offset

The work group should also consider alignment with enterprise projects underway, including replacement of the state's core financial systems. Washington recently completed the planning and strategy phase for this project, which calls for implementation of an enterprise resource planning system that includes debt-offset functionality. There may be similarities and research available on governance and resources the work group should consider.

Action Steps and Time Frame

- None applicable. *Directed to the Legislature.*

SAO Recommendation 4: Taking into account the workgroup's June 2016 report, the Legislature authorize a single comprehensive statute to offset debts owed by businesses with payments to those businesses.

STATE RESPONSE:

The agencies audited for this report recognize the complexity and potential for a comprehensive debt-offset program. If the Legislature provides funding and directive for a work group, we believe there is potential for cross-agency debt-offsets to complement debt collection tools and help rein in the underground economy – those individuals and businesses that conceal their true tax liability to government.

Action Steps and Time Frame

- None applicable. *Directed to the Legislature.*

Appendix A: Initiative 900

Initiative 900, approved by Washington voters in 2005 and enacted into state law in 2006, authorized the State Auditor's Office to conduct independent, comprehensive performance audits of state and local governments.

Specifically, the law directs the Auditor's Office to "review and analyze the economy, efficiency, and effectiveness of the policies, management, fiscal affairs, and operations of state and local governments, agencies, programs, and accounts." Performance audits are to be conducted according to U.S. General Accountability Office government auditing standards.

In addition, the law identifies nine elements that are to be considered within the scope of each performance audit. The State Auditor's Office evaluates the relevance of all nine elements to each audit. The table below indicates which elements are addressed in the audit. Specific issues are discussed in the Audit Results and Recommendations section of this report.

I-900 element	Addressed in the audit
1. Identification of cost savings	**No.** However, the audit found debt-offset programs can help Washington recover delinquent business debt faster.
2. Identification of services that can be reduced or eliminated	**No.** The audit objectives did not include identification of services that can be reduced or eliminated
3. Identification of programs or services that can be transferred to the private sector	**No.** The audit objectives did not include identification of programs or services that can be transferred to the private sector.
4. Analysis of gaps or overlaps in programs or services and recommendations to correct gaps or overlaps	**Yes.** The audit found the state does not have a systematic method to identify when delinquent businesses are receiving payments from the state. The audit discusses how an offset program can help agencies intercept those payments to recover delinquent debt.
5. Feasibility of pooling information technology systems within the department	**No.** The audit objective did not include analyzing the feasibility of pooling information technology systems.
6. Analysis of the roles and functions of the department, and recommendations to change or eliminate departmental roles or functions	**Yes.** The audit identified selecting a lead agency as a necessary component to administer an effective offset program and maximize its benefits
7. Recommendations for statutory or regulatory changes that may be necessary for the department to properly carry out its functions	**Yes.** The audit recommends the legislature authorizes a single comprehensive statute to allow state agencies to offset state debt with state payments and to participate in the U.S. Treasury's State Reciprocal Program.
8. Analysis of departmental performance, data performance measures, and self-assessment systems	**No.** The audit objective did not include an analysis of performance data or measures.
9. Identification of best practices	**Yes.** The audit identified leading practices other states recommend to implement and administer effective debt-offset programs.

Appendix B: Methodology

This audit was designed to answer three questions:

1. Can a state debt-offset program help Washington collect delinquent business debt?
2. Can participation in the U.S Treasury's State Reciprocal Program help Washington collect delinquent business debt?
3. What actions would Washington need to take to develop and implement effective debt-offset programs?

To answer our audit questions, we:

- Estimated the amount of delinquent business debt Washington could have recovered in one month with a state debt-offset program.
- Researched literature and interviewed nine states that use offset programs to collect business debt to identify leading practices, lessons learned and benefits achieved. Also, to gain an understanding of how states designed, manage and fund their offset programs.
- Reviewed relevant laws in Washington and interviewed states agencies to identify additional changes the state would need to make to implement and administer effective debt-offset programs.

Estimate of potential debt collections with a state debt-offset program

Although a state debt-offset program can also be used to collect debt owed by individuals, this audit focused on debt owed by businesses. To estimate how much outstanding delinquent debt a state debt-offset program could have potentially recovered for Washington in one month, we did the following:

- We calculated the amount of outstanding delinquent debt that businesses incurred with five agencies in fiscal year 2013 and which they still owed at the end of the same fiscal year.
- We then used federal TINs to compare this amount to payments eight agencies made to businesses in June 2013. The federal TIN was either a Social Security Number (SSN) or federal employer identification number (FEIN).

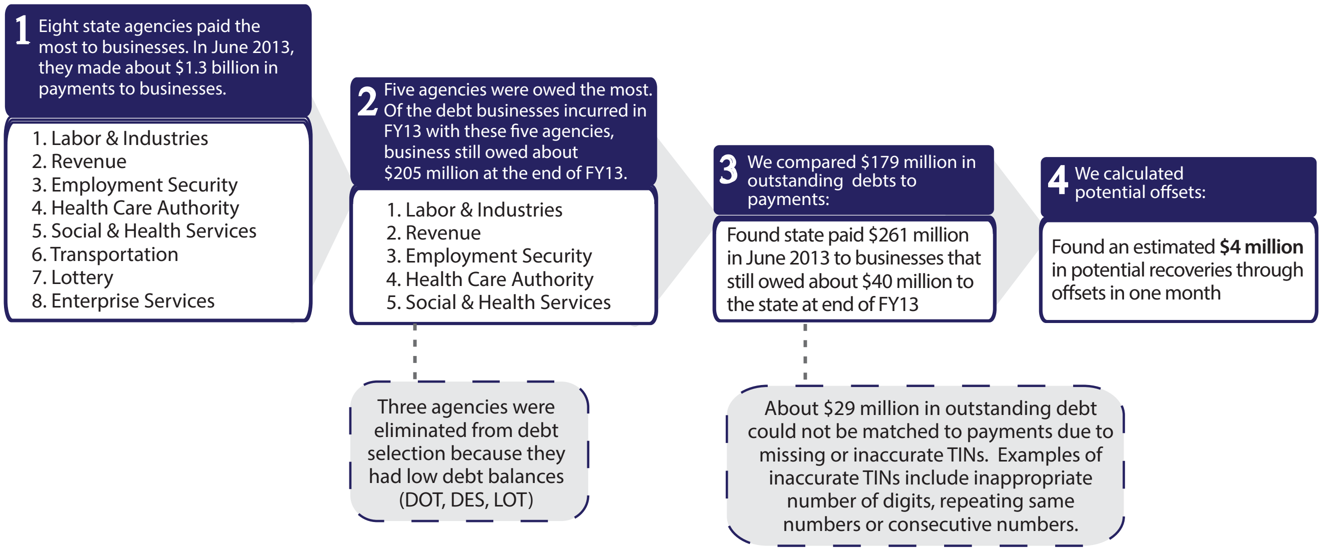
In general, our estimate assumes:

1. The state debt-offset program existed in the month of comparison (June 2013).
2. The state had authorized the debts and payments we included in the analysis for offset.
3. No prioritization: We assumed all debts a business owed to any or all the five agencies was debt owed to the state of Washington, in order to eliminate the need to determine which agency should get priority over potential collections in the analysis. As a result, the estimate of potential recoveries with a state debt-offset program cannot be specifically allocated to the five state agencies.

Interests and penalties: Although a debt-offset program can collect interest and penalties in addition to the debt principal, we excluded them from this analysis (whenever possible) because we could not predict how much would have been assessed if an offset program had been in place during the month of our estimate.

Figure 1 on the following page shows the steps we performed in the analysis to estimate potential debt collections for Washington with a state debt-offset program. These steps are described in more detail in

Figure 1 - Steps used in the analysis to determine potential collections for Washington with a state debt-offset program



the text that follows the graphic.

We first identified a sample of state agencies to review. **Box 1** lists the agencies that we asked to supply fiscal year 2013 payment and delinquent business debt data for analysis. Although other agencies are also owed business debt and make payments to businesses, we selected eight agencies making substantial payments to businesses.

The eight agencies selected for payments paid about $1.3 billion to businesses in June 2013 (the month of the estimate). Business payments included in the analysis consist of state and unemployment tax refunds, retrospective rating refunds, payments for products and services (that is, provider and vendor payments), unclaimed property, and lottery winnings to business owners.

We next eliminated three agencies from debt analysis because they had low debt balances. For the remaining five agencies, we calculated the amount of outstanding delinquent debt that businesses incurred with them and which was still owed at the end of the same fiscal year.

As shown in **box 2**, businesses incurred and still owed about $205 million in outstanding delinquent debt to the five agencies selected for debt review, including state and unemployment taxes, worker's compensation premiums, and medical and social service debts. The agencies considered these debts delinquent during the review period; they told us they had attempted to collect through collection actions such as warrants, liens, levies, notice to withhold and deliver, and others. Each agency sets its own timeline of when they consider a debt delinquent and when they start collection actions to recover debts.

We then used federal TINs to compare the amount of outstanding delinquent debt businesses incurred and still owed to five agencies in fiscal year 2013 to the payments businesses received from eight agencies in June 2013. As shown in **box 3**, we found that in June 2013, agencies paid $261 million to businesses that still owed about $40 million in outstanding delinquent debt at the end of the fiscal year.

We could not match all debt to payments because about $29 million (14 percent) of the total outstanding delinquent debt lacked or had inaccurate TINs. As a result, we could not estimate all debt a state debt-offset program might have recovered for Washington in June 2013.

Finally, when we identified matches between businesses that owed debt and those who received payments in June 2013, we calculated the amount of debt a state debt-offset program could have collected in that month. An offset program can only offset a payment up to the full amount of debt owed. Thus, if payments businesses received were greater than their debt, the offset amount was equal to the debt. If payments were less than the debt, the offset amount was equal to the payment.

In **box 4**, we see that an offset program could have potentially recovered about $4 million (10 percent) of this debt in one month. Note that not all $40 million in outstanding delinquent debt could have been recovered in one month because some of the businesses that owed a significant portion of this debt did not receive sufficient payments in the month of our estimate.

Estimate of potential debt collections with participation in the U.S. Treasury's State Reciprocal Program

We coordinated with four Washington agencies (Social and Health Services, Health Care Authority, Employment Security, and Labor and Industries) to send a portion of their outstanding delinquent business debt to the U.S. Treasury for analysis.

To estimate the amount of potential collections if Washington participated in the federal program, we asked the U.S. Treasury to match a portion of the outstanding delinquent debt businesses owed to four state agencies against one month of federal vendor payments. The U.S. Treasury's current testing environment can only compare one month of federal vendor payments against outstanding state debt. Although initial results were available, Treasury officials indicated in November 2014 that they needed to make revisions to their estimates. The revised results are expected early in 2015.

Treasury's initial results found a significant number of accounts that could not be matched to federal payments because they matched payments on a business' TIN but not business name.

Leading practices and lessons learned in other states

We conducted nationwide research to find states that have authority to operate an offset program to collect business debt and to identify the characteristics of offset program design in other states. Of the 29 states that apply offset programs, we selected nine for review based on factors such as tax structure, level of centralization in debt collection, funding model, state agency participation requirements, and participation in the U.S. Treasury's State Reciprocal Program.

We sought to gain an understanding of how these states designed, manage and fund their offset programs, challenges experienced in implementing the program, benefits achieved and practices and lessons for developing effective debt-offset programs.

Brief summaries of our research are in **Appendix D**.

States interviewed

Kansas	North Carolina
Kentucky	Texas
Maryland	Virginia
Minnesota	Wisconsin
Nevada	

Changes Washington would need to make

We reviewed relevant sections of the Revised Code of Washington (RCW) and Washington Administrative Code (WAC) to identify legal barriers to implementing debt-offset programs in Washington. We also interviewed each agency included in the audit to learn about existing statutory, system, process or other limitations that those agencies regard as a barrier to offset program implementation.

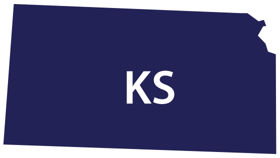
With this understanding of Washington's current condition, plus the information we learned from other states, we determined the legislative, system and process changes Washington would need make to implement and administer effective state and federal debt-offset programs.

Appendix C: State Profiles

The following state profiles provide information gathered through interviews with offset program administrators in nine states, the U.S. Treasury, and our review of the statutes that authorize the use of an offset program in these states.

Many of the states we interviewed use several different types of offset programs that collect money owed by businesses and individuals; or they may use an offset program as part of a larger centralized debt collection program. As a result, it was not always possible to separate the specifics of the business debt-offset program from other types of offset or debt collection programs. The following table's profiles are specific to business debt-offset programs unless otherwise noted.

Of the nine states we interviewed, four participate in the U.S. Treasury's State Reciprocal Program (Kentucky, Maryland, Minnesota, and Wisconsin). The U.S. Treasury provided recent collection amounts for states that participate in its State Reciprocal Program.



Kansas

Type(s) of offset program(s)	• Individual Offset • Vendor (business) Offset
Lead agency(ies)	Kansas's Department of Administration administers the state's offset programs.
Eligible program participants	State agencies, municipalities, courts, colleges and school districts, city and county hospitals, and emergency medical services.
Participation requirements	Participation is voluntary.
Funding model	The program charges 17 percent fee on the amount collected to state agencies and an additional 5 percent fee if the debt file is incomplete and requires research. Other fees are charged to municipalities. These fees fund the costs of the programs.
Types of debt that can be collected	Debt owed to participating state agencies, sales taxes, drug taxes, unemployment taxes, other taxes, overdue and court ordered child support, debt owed to municipalities, federal income taxes, debt owed to other states. The debt balance must be at least $25 to qualify for offset.
Types of payment that can be used for offset	Tax refunds, homestead tax refunds, food tax refunds, vendor payments, lottery winnings, payroll, employee travel payments, unemployment benefit payments, Kansas Public Employee Retirement System's disability and retirement payments, and unclaimed property.
Priority system for offsets	1. Tax debt owed to state agencies 2. Child support debts 3. Debts that have been written off 4. Other state debt in order of filing with the Director of Administration 5. Tax liabilities owed to another state in order of filing with the Director
Due process	State agencies must make three attempts to collect the debt before referring it for offset. When an offset is identified, the debtor is provided with written notice and 15 days to appeal.
Authorization for data sharing	KSA §75-6212 – "Notwithstanding any provision of law prohibiting disclosure by the department of revenue of the contents of taxpayer records or information and notwithstanding any confidentiality statute of any state agency, foreign state agency or municipality, all information exchanged among the department of revenue, any other state agency, foreign state agency or municipality and the debtor necessary to accomplish and effectuate the intent of this act is lawful."
Recent collection amount	• Approximately $1.6 million in FY13 through vendor offsets • About $28 million total in FY13 through individual and vendor offsets
Offset code	Kansas Statutes Annotated §§75-6201 - 6215

Kentucky

Type(s) of offset program(s)	• Individual Offset • Vendor (business) Offset • U.S. Treasury's State Reciprocal Program
Lead agency(ies)	The Department of Revenue administers the state's central debt collections program, called Enterprise Debt Collection (EDC), which collects debts on behalf of state agencies using many methods including offsets. Revenue sends debt files to the Office of the Controller daily to offset against vendor payments.
Eligible program participants	State agencies, courts and local government.
Participation requirements	Participation is voluntary for state agencies that meet minimum collection requirements.
Funding model	DOR received a one-time allocation from the legislature in 1998 for system upgrades to implement the state offset program. Debtors are charged $17 fee per offset conducted through the U.S. Treasury's State Reciprocal Program and 25 percent fee on the amount collected through the state offset program. These fees fund the costs of the programs.
Types of debt that can be collected	Debts owed to state agencies by individuals and businesses. Corporate officers can be held accountable for debts owed by businesses. Debt balance should be at least $100 to qualify for offset through EDC.
Types of payment that can be used for offset	Any payments made by the state except the following: withholding taxes, employee deductions, U.S. savings bonds, deductions required by law, social security payments, worker's compensation benefits, medical and dental benefits, 1099 or other care and support payments, grants-in-aid to state government agencies, right-of-way relocation expenses, pension benefits, insurance premiums, and county elections.
Priority system for offsets	1. Debts owed to the Department of Revenue 2. Debt owed to state agencies in descending order of claim size 3. Debt owed to county, city, urban-county government, consolidated local government, charter county in descending order of claim size
Due process	The agency must attempt to collect the debt within 60 days of identification prior to referring it to the offset program. When the program finds an offset, the debtor is given 30 days to appeal.
Authorization for data sharing	No information available.
Recent collection amount	• $17 million in FY13 through a centralized debt collection program that recovers debts through offsets and other methods. • $8.6 million in FY13 through the U.S. Treasury's State Reciprocal Program.
Offset code	Kentucky Revised Statutes §45.241, §131.030, and §§131.560-595

Maryland

Type(s) of offset program(s)	• Individual Offset • Vendor (business) Offset • U.S. Treasury's State Reciprocal Program
Lead agency(ies)	The Central Collection Unit (CCU), within the Department of Management and Budget, works with the Comptroller's Office to conduct offsets. The Comptroller's Office manages the vendor offset and U.S. Treasury's State Reciprocal Programs.
Eligible program participants	State agencies, universities, and taxing entities in municipalities.
Participation requirements	Participation is mandatory.
Funding model	Debtors are charged $17 fee per offset conducted through the U.S. Treasury's State Reciprocal Program and 17 percent fee on the amount collected for offsets conducted through state offset programs. These fees fund the costs of the programs.
Types of debt that can be collected	Debt owed to state agencies including but not limited to taxes, student loans, tolls, parking and moving violations, food stamp overpayments, unemployment debt, and debts owed to the automobile insurance fund. The debt must be at least $25 to qualify for offset.
Types of payment that can be used for offset	Payments made by the Comptroller including tax refunds and vendor payments, and lottery winnings.
Priority system for offsets	1. Unpaid state, county, or municipal taxes 2. Child support 3. Amounts received by a person from an insurer for the cost of health services provided to a child which was not used to reimburse the Department for Medicaid costs incurred 4. Debt collected by the Central Collections Unit 5. Any other debt owed to the State, county, or other political subdivision of the State 6. Tax liabilities owed to another state 7. Nontax debt owed to the Federal government
Due process	State agencies must attempt to collect the debt for 90 days before it is submitted to CCU for offset. When an offset is identified, the debtor is given 30 days to appeal.
Authorization for data sharing	No information available.
Recent collection amounts	• $7.4 million in FY13 through vendor offsets. • $8.7 million in FY13 through the U.S. Treasury's State Reciprocal Program.
Offset code	Code of Public General Laws (Statutes) of Maryland – State and Finance Procurement Article §§3-302 - 307 and Tax – General Article §§13-912 - 919

Minnesota

Type(s) of offset program(s)	• Individual Offset • Vendor (business) Offset • U.S. Treasury's State Reciprocal Program
Lead agency(ies)	The Department of Revenue administers all offset programs in collaboration with the Department of Management and Budget.
Eligible program participants	State agencies, universities, and courts.
Participation requirements	Participation is voluntary.
Funding model	Debtors are charged $20 fee per offset conducted through the U.S. Treasury's State Reciprocal Program and $15 per state' tax refund offset to recover state debt. Other state offset program's fees vary not to exceed 25 percent of the debt. These fees fund the costs of the programs.
Types of debt that can be collected	Taxes and other debts owed to state agencies by individuals and businesses that provide goods and services to the state of Minnesota.
Types of payment that can be used for offset	Tax refunds and payments made by Minnesota's Department of Human Services, Department of Management & Budget, and University of Minnesota.
Priority system for offsets	Revenue Recapture program's offset priorities are as follows: 1. State taxes 2. Child support 3. Court-ordered criminal restitution 4. Health care 5. Claims by other agencies in Minnesota with the oldest debt given first priority 6. Claims by government agencies from other states 7. IRS claims
Due process	When an offset is identified, the debtor is notified and given 30 days to appeal.
Authorization for data sharing	§270C.65 Subd 3 – "Notwithstanding any provision to the contrary, every person, organization, or corporation doing business… with the state of Minnesota… shall provide that agency with either their Social Security number, federal taxpayer identification number, or Minnesota tax identification number."
Recent collection amount	• State vendor offset program's collections data was not available because the program has been on hold due to system upgrades. • $2 million in FY13 through the U.S. Treasury's State Reciprocal Program. Minnesota said that participation in this program helped them balance the budget and end the state's government shutdown in 2011.
Offset code	Minnesota Statutes §270C.65 Right of Setoff (vendor offset) and §270C.41 Agreement with Federal Government (U.S. Treasury's State Reciprocal Program)

Nevada

Type(s) of offset program(s)	• Individual Offset • Vendor (business) Offset
Lead agency(ies)	The Nevada's Office of State Controller administers the vendor debt offset program and also serves as the central debt collection agency and central payment agency for the state.
Eligible program participants	State agencies.
Participation requirements	Participation is mandatory.
Funding model	The Office of State Controller charges a 5.5 percent collection fee on the amount collected for debt recovered through the offset program. The debtor pays the fee if debt is over $300. State agencies pay the fee if the debt is under $300. The legislature allocates some funding to help with administrative costs for all collection programs.
Types of debt that can be collected	Any type of debt businesses owe to state agencies such as taxes, fees and fines. Debt must be 60 days past due to qualify for offset.
Types of payment that can be used for offset	Any type of payments the state makes to vendors who owe debt to the state, except some payments that are funded with federal dollars.
Priority system for offsets	The program offsets debt on a first-come, first-served basis. Agencies who submit their delinquent debt first get priority over others for collections.
Due process	When the program finds an offset, debtors are provided with written notice and 10 days to appeal.
Authorization for data sharing	No information available.
Recent collection amount	About $1 million as of FY13 through vendor offsets. Nevada does not have an automated offset program. The state is currently consulting with CGI to automate its offset program and improve its efficiency and effectiveness.
Offset code	Chapter NAC 353C: Collection of Debt Owed to State Agency

North Carolina

Type(s) of offset program(s)	• Individual Offset • Vendor (business) Offset
Lead agency(ies)	The Office of State Controller and Department of Revenue collaborate to administer the vendor offset program and the setoff debt collection program.
Eligible program participants	State agencies and local agencies. Currently only the Department of Revenue can collect debt through the vendor offset program. However, any registered state and local agency can recover debt through the state's setoff debt collection program.
Participation requirements	Participation in vendor and setoff debt collection programs is mandatory. Currently, the vendor offset program is only available to the Department of Revenue, but the state is working to expand this program to other state agencies.
Funding model	Funding for the vendor offset program is incorporated into the budgets for the agencies involved; so there are no fees charged for offset. A $5 fee per offset is charged to debtors in the setoff debt collection program. Other fees are charged to local government agencies. These fees cover the costs of the program.
Types of debt that can be collected	The vendor offset program currently collects individual income tax and corporate tax debt. The setoff debt collection program collects any debt owed to state agencies.
Types of payment that can be used for offset	The vendor offset program offsets any vendor payments made through the state's accounting system. The setoff debt collection program offsets state tax refunds.
Priority system for offsets	1. State taxes owed to the Department of Revenue 2. Debt owed to state agencies based on date of registration with offset program 3. Debt owed to local agencies based on date of registration with offset program
Due process	State agencies are required to make three unsuccessful attempts to collect the debt within 90 days of debt becoming delinquent and allow the debtor to establish a payment plan before the debt can be referred for offset.
Authorization for data sharing	§105A-15 – "Notwithstanding G.S. 105-259 or any other provision of law prohibiting disclosure by the Department of the contents of taxpayer records or information and notwithstanding any confidentiality statute of any claimant agency, the exchange of any information among the Department, the claimant agency, the organization submitting debts on behalf of a local agency, and the debtor necessary to implement this Chapter is lawful."
Recent collection amount	• $2.1 million in FY13 through vendor offsets. • About $79 million in FY12 through individual offsets.
Offset code	Setoff debt collection program: North Carolina General Statutes §105A Vendor Garnishment offset program: NC Gen. Stat. §105-242(b)

Texas

Type(s) of offset program(s)	• Individual Offset • Vendor (business) Offset
Lead agency(ies)	The Comptroller's Office manages the program.
Eligible program participants	State agencies and higher education institutions.
Participation requirements	Participation is mandatory.
Funding model	The Comptroller's Office absorbs the cost of the program; there are no fees charged for offsets.
Types of debt that can be collected	Any debt businesses and individuals owe to state agencies can be recovered through offsets as long as the agency has statutory authority to collect the debt.
Types of payment that can be used for offset	All payments that are processed through the Comptroller's Office can be used for offset. However, payroll and annuity are only held for child support debt. The program does not offset payments funded with federal dollars.
Priority system for offsets	1. Child support 2. Taxes owed to the Comptroller's Office (e.g. franchise tax and sales tax) 3. Debt owed to state agencies in order of submission to the debt-offset program
Due process	Agencies are required to provide due process to debtors before the debt can be submitted for offset. Once an offset is identified, the debtor is given 30 days to appeal.
Authorization for data sharing	No information available.
Recent collection amount	$13 million in FY13 through vendor and individual offsets.
Offset code	Government Code § 403.055, 403.0551, and 403.0552

Virginia

Type(s) of offset program(s)	• Individual Offset • Vendor (business) Offset
Lead agency(ies)	The Department of Taxation and the Department of Accounts collaborate to administer the state's offset programs. The Department of Taxation has direct responsibility for the individual offset program and the Department of Accounts has direct responsibility for the vendor offset program.
Eligible program participants	State agencies can participate in the vendor offset program. State agencies, local agencies and courts can participate in the individual offset program.
Participation requirements	Participation is mandatory for state agencies and courts and voluntary for localities.
Funding model	The Department of Taxation absorbs the costs for the individual offset program and does not charge a fee to state agencies.
Types of debt that can be collected	The vendor offset program collects any debts owed to state agencies. The individual offset program collects debts owed to state agencies, courts, and localities.
Types of payment that can be used for offset	Payments made by the Department of Accounts, vendor payments, tax refunds, and lottery winnings.
Priority system for offsets	Priorities for offset programs are as follows: 1. Tax debt owed to the Department of Taxation 2. Child Support Enforcement 3. Debt owed to state agencies, state boards, state authorities and courts on a first-come, first-served basis 4. Local Department of Social Services 5. Counties, cities, towns, and local authorities
Due process	The debtor is notified and given 30 days to appeal.
Authorization for data sharing	§ 58.1-533 – "Notwithstanding § 58.1-3 or any other provision of law prohibiting disclosure by the Department of the contents of taxpayer records or information and notwithstanding any confidentiality statute of any claimant agency, all information exchanged among the Department, claimant agency, and the debtor necessary to accomplish and effectuate the intent of this article shall be lawful."
Recent collection amount	• $56 million in FY11 through vendor offsets. • $52 million in FY11 through individual offsets.
Offset code	Code of Virginia §§2.2-4800-4809 (vendor offset) and §§58.1-520 - 58.1-535 (individual offset).

Wisconsin

Type(s) of offset program(s)	• Individual Offset (Tax Refund Intercept Program) • Vendor (business) Offset (State Debt Collection Program) • U.S. Treasury's State Reciprocal Program
Lead agency(ies)	The Department of Revenue administers the offset programs and works with the Department of Administration to match with payments made by the state.
Eligible program participants	State and local agencies.
Participation requirements	Participation is mandatory for state agencies and voluntary for local agencies.
Funding model	The Department of Revenue prepaid for the cost to build the offset programs initially and recover the cost over time through fees. Debtors are charges $17 fee per offset conducted through the U.S. Treasury's State Reciprocal Program. The fee for the tax refund offset program is $5 per offset and the fee for the State Debt Collection program is 15 percent on the amount collected.
Types of debt that can be collected	Any debt owed to the state.
Types of payment that can be used for offset	Tax refunds, vendor payments, payments made by the Department of Administration, and lottery winnings over $1,000.
Priority system for offsets	1. Tax debt 2. Child support 3. State agency debt and debt owed to the courts and legislature 4. Debt owed to local units of government 5. Other qualifying debt 6. Child support owed in another state 7. Federal tax obligations 8. Tribal obligations 9. Tax and nontax obligations of other states
Due process	State agency must provide debtor with written notice 30 days prior to referral of debt to offset program.
Authorization for data sharing	§71.93(7) - Exchange of information. Information relative to changes to any debt certified shall be exchanged promptly by each agency. Setoff of refunds and reduction of disbursements against debts certified by agencies, and any report of the setoff or reduction to state agencies, is not a violation of ss. 71.78, 72.06, 77.61 (5), 78.80 (3), and 139.38 (6).
Recent collection amount	• $9.7 million in FY13 through a State Debt Collection Program that recovers debts through vendor payment offsets, tax refund offsets and other methods. • $84.7 million in FY13 through individual tax refund offsets. • $1 million in FY13 through the U.S. Treasury's State Reciprocal Program.
Offset code	Wisconsin Statutes §71.93 and 71.935

Appendix D: Description of Process and System Changes Needed

Washington would need to develop offset processes that are clear and standardized and automate them as much as possible.

Offset program officials said automated, clear and standardized processes are key to operating a successful debt offset program. The lead agency needs to develop three main areas in collaboration with participating agencies: the management of delinquent debt data, a process for identifying offsets, and protocols for communicating with claimant agencies and businesses.

Develop processes for transmitting and receiving debt and a repository for debt files.

Agencies will need a method to send their eligible delinquent debts to the lead agency and update those accounts as payments, adjustments, penalties, and interest occurs.

The lead agency should be the administrator of the system that manages all debts that are eligible for offset. The Department of Enterprise Services has suggested that agencies could transmit their debt files using existing tools in the state's centralized payment system, AFRS, or they could send the files directly to Enterprise Services for uploading into AFRS.

Maryland, North Carolina, Texas, and Virginia provide multiple options for submitting debts including online submission, secure file transfer, Winzip, CD, diskette, and paper files.

The lead agency should develop processes and rules for receiving debt files from and sending debt files to agencies that will address the different debt collection systems currently in place. These processes should include a required file format for submitting debts, options for submitting those debts, and expectations for agencies to update debt files on a regular basis.

Establish procedures for identifying potential offsets.

After debts from participating agencies are consolidated in a single place, the offset program can match them against outgoing payments to determine whether an offset can take place. Officials at Enterprise Services told us that, with programming, this match could be conducted through AFRS. For example, outgoing AFRS payments could be matched against the consolidated debt file described above during the standard nightly system refresh.

For the offset matching process to be successful, other states recommend that the lead agency set rules for identifying matches. The lead agency should develop a method for identifying delinquent businesses that are receiving state payments to ensure payments to compliant businesses are not withheld. To ensure the accuracy of the match, some states we spoke with use federal TINs in combination with a second identifier to find potential offsets.

Wisconsin matches businesses by federal TIN and first six characters of the business name, and matches individuals by federal TIN and the first four characters of the individual's last name.

Create a process for communicating with claimant agencies and businesses.

In other states, when a match is identified the business and claimant agency are notified of the potential offset. Because Washington's debt collection functions are undertaken by a number of agencies, the state lacks a standard method for state agencies to communicate with each other about debt collection. Offset programs in other states have ensured effective communication between the lead agency, participating agencies, and businesses by creating expectations for regular communication.

Once a match is identified by the lead agency, other states recommend that agencies verify the debt amount is still accurate and legally due. The lead agency should set expectations for agencies to respond to verification requests in a timely manner.

The Kansas, Texas, Virginia, and Wisconsin offset programs direct customers to claimant agencies if there are questions and concerns. For example, Wisconsin provides a contact number for the claimant agency at the top of each notice of offset and a web inquiry tool that sends questions directly to the claimant agency.

Businesses should also be notified after a match is identified and the validity of the debt is verified. Other states suggest that the notification include information about the debt that is being collected, the payment that will be withheld, opportunities for contesting the offset, and a phone number for contacting the agency that holds the debt. The claimant agency should be responsive when businesses call to ask questions about the offset and should provide training to staff in answering questions about the program. Offset program administrators recommend that the lead agency not be responsible for answering customer service questions regarding the debt because the lead agency is not the expert in the debt and the volume of calls can be burdensome.

Automate offset processes as much as possible

Offset program officials explain that automating offset processes will help to reduce error, ensure rules and laws are fully adhered to, and reduce the amount of staff time and resources required for administering the program.

Enterprise Services suggests that many of the procedures and changes described above can be automated through AFRS with programming. Some staff time will be necessary for file transfers, file updates and customer service phone calls. However, automating the following computer processes will greatly improve the efficiency and effectiveness of the offset program.

- **Accept only debt files that are correctly formatted.** Automating this process will allow the system containing the consolidated debts to only accept debt files that are submitted with the right data and in the format required by the lead agency. Files that are formatted incorrectly or are missing data will be returned to the claimant agency so they can be edited and resubmitted.
- **Incorporate laws and business rules into the system match.** Offsets can be applied based on a number of criteria including business' TIN, type of debt or payment, and order of priority. Enterprise Services suggested criteria could be programmed so that rules will be automatically taken into account during the offset match.
- **Calculate offsets and issue payments.** AFRS could be programmed to calculate the amount of payment that should be paid to the claimant agency and the amount that should be paid to the business. In addition, AFRS could automatically issue payments to the claimant agency and the business at specific times during the offset process.
- **Issue notices to business and claimant agency.** The offset program will need to notify the claimant agency of the potential offset, issue a notice to the debtor when a match is identified, and possibly issue a notice once the offset is complete. All of these notices could be fully automated through the AFRS system to coincide with actions that are taken during the offset process.

Appendix E: U.S Treasury's State Reciprocal Program Legislative/Regulation Checklist

TREASURY OFFSET PROGRAM
State Reciprocal Offset Program
State Legislation/Regulation Check List

Background: States are permitted to submit delinquent state debts for collection by offset of certain federal payments through the Treasury Offset Program (TOP) operated by theDepartment of the Treasury's Financial Management Service (FMS). Debt must be submitted in accordance with reciprocal agreements, pursuant to the authority set forth in 31 U.S.C. 3716(h) and corresponding regulations at 31 CFR 285.6. The law requires states to have authority (whether through regulations or legislation) to enter into, and abide by the terms of, the reciprocal agreements.

Counsel for state lawmakers and regulators should thoroughly review the reciprocal agreement and the laws cited above before drafting legislation and/or regulations to ensure that appropriate state officials can enter into the reciprocal agreement.

Essential Items: While states must abide by all the terms of the reciprocal agreement, the following are most often affected by state legislation:

1. Authority to offset state tax refunds. If the state issues any tax refunds, they must be subject to offset to collect federal debts.
2. Authority to offset other state payments. Legislative authority should be broad enough to include all state payments specified in the reciprocal agreement.
3. Authority for appropriate state official to submit state debts to TOP. TOP generally only accepts one or two points of connection with a state; so the authorized official(s) should be the officials that are capable of submitting the debt.
4. Authority for FMS to deduct a fee from offset collections. Federal law requires that FMS charge a fee to cover its costs of running the TOP program. FMS withholds a portion of each collection it makes from a federal payment for a state as its fee. States are free to add that fee amount to the debt balance, if state law authorizes it.
5. No authority to charge FMS a fee. Federal law does not permit FMS to pay a fee to the states when the state offsets a payment to collect a federal debt.
6. Due process. State law cannot require FMS or federal agencies to provide different due process from that set forth in the agreement and in 31 CFR 285.6.

If state officials have any questions about these legal requirements,
they should contact David Burgess, SRP Program Lead,
at 202-874-7182 or via email at David.Burgess@fms.treas.gov.