

Office of the Inspector General

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An Opportunity for Taxpayer Savings Through Improving Statewide Accounts Receivable Practices

I. Executive Summary

Applying accounts receivable best practices by individual agencies and pursuing several potential statewide solutions could yield millions, if not tens of millions, of dollars in taxpayer savings. The 2013 statewide Annual Debt Collection Report reported the Executive Branch's self-reported past due accounts receivables of \$1,021,950,073, which was certainly a sign of concern and an opportunity for taxpayer savings through improvement. Analysis determined this report's data had substantial accuracy and reliability issues, such as not including \$57 million unreported by 16 agencies and unclear guidance on reporting debt previously written-off which added hundreds of millions of dollars to the debt. The upcoming 2014 report, due in February 2014, will have improved data collection guidance and standardized reporting to establish an accurate statewide baseline to move forward. Regardless of the final accurate statewide past due debt, improving the effectiveness of managing statewide accounts receivables, both in total and past due accounts, represents a potential significant taxpayer savings--a small percent improvement on a large statewide past due debt is a big savings.

The SIG interviewed a cross section of thirty state agencies to develop a baseline understanding of accounts receivable programs in state government. SIG determined a few agencies were exceptional, characterized by a very pro-active approach to policies, debt collection procedures, and metrics for results to drive continuous improvement, while others were complacent. Most agencies landed between these two extremes creating an overall bell curve of how state agencies managed accounts receivables, particularly collecting past due debt.

The start for individual agency improvement is to compare its accounts receivable program to best practices, which will identify areas for potential improvement. Accounts receivable best practices can be summed up in a few conceptual steps: prevention; collect early and often; collect locally; and proactively persistent. Best practices do not always translate to every agency due to different business models, but it is the place to start an improvement initiative. Specific best practices included: prevention; invoice at delivery; invoice often; telephone contact between invoices; collect locally; late payment penalties; exploit technology; doubtful accounts receivable policy; and proactive vigilance—leadership. Improving an individual agency's accounts receivable program should not be viewed as a one-time comparison to best practices. Any group of policies and procedures require the development of metrics for success and periodic review which, in turn, creates a program capable of continuous improvement.

The South Carolina Department of Revenue's (DOR) programs available to state agencies to promote collection of past due receivables were under-exploited. DOR's Set-Off Program compares an agency's past due account to the debtor's refund due, and, if available, remits the debtor's refund to the agency to off-set the debt owed. DOR's Government Enterprise Accounts Receivable Program (GEAR) Program is a more intensive collection effort using traditional collection methods found in the private sector with a uniquely distinguishing capability to levy against assets and to garnish wages to satisfy the debt owed. Five issues were identified inhibiting state agencies from fully exploiting DOR's past due accounts receivable collection programs: many agencies did not have an accurate understanding of DOR's two programs; GEAR's 28.5% fee was higher than the private sector; GEAR does not pass on its collection fees to debtors; DOR requires taxpayer identification numbers on accounts submitted for collection; and DOR's technology interface with agencies needed improvement.

During the SIG review, DOR noted its interest in understanding how the agency, particularly GEAR, can better serve state agencies. DOR described the history of GEAR being considered the debt collector of last resort, which certainly played a role in the existing factors inhibiting agencies from using GEAR. DOR deemed it had some flexibility to address the issues identified inhibiting state agencies from fully exploiting GEAR, while some changes will require legislative action. With seemingly modest modifications to GEAR, DOR could stand as the collection agent of first resort for all state agencies after exhausting their internal efforts, rather than the last. DOR should be able to lower its fees charged to state agencies after it recovers its fair costs, which, in turn, will incentivize agencies to use DOR for cost savings. Given its unique capabilities and potential significant collection cost savings to agencies and, correspondingly, taxpayers, GEAR should have the first opportunity to collect the state's debt as long as it is competitively advantageous over private sector agencies.

Almost every agency reviewed had some issue with checks returned for insufficient funds. The review identified two potential statewide solutions. First, a change in the current state statute would permit agencies to bring a collection action in local Magistrate's court, which is currently prohibited. Second, agencies currently underutilize their local Solicitor's Worthless Check Units, which provides an effective service at no cost to an agency.

Other opportunities observed in agencies with statewide application were: fully exploiting technology by engaging SC.Gov, also known as SC Interactive, to create an online payment system and automate customer data submission; and cooperation among agencies to leverage information or regulations to enhance the effectiveness of collecting delinquent accounts receivables.

The difference between exceptional and mediocrity in any function of government, to include accounts receivable, is management's skill at building a program that measures results, which are then fed back into the program to stimulate continuous improvement and an accountability mindset by the program's operators. A finance director of an exceptional program provided a great analogy viewing the collection process as a series of waterfalls. At each level, there was the opportunity to collect funds where employees proactively worked to maximize the opportunity; this same agency measured results throughout the organization so employees realized their efforts would ultimately be a reflection of their individual or unit's contributions. Lesser programs had less collection steps and less of a performance link with results, to include instances of agencies giving the appearance of just going through the motions prior to writing off the debt. The primary direction for overall improvement is two-fold: 1) individual agencies should compare their programs with best practices, exploit opportunities to improve, and incorporate success metrics to drive a program capable of continuous improvement; and 2) explore options to enhance DOR's GEAR program which will have a positive statewide impact on the collection of delinquent accounts receivable debt, lower administrative handling costs, and save fees to private debt collectors.

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II. Background

A. Objectives

This review was predicated upon FY 2013-2014 Legislative Proviso 117.38, which required each agency to produce a past due debt report, known as the Annual Debt Collection Report, summarizing agency receivables in excess of 60 days. The calendar year 2013 report determined the aggregate Executive Branch agency accounts receivables in excess of 60 days to be \$1,021,950,073, which was a 74% increase from the \$585,589,463 in 2012. Given the sheer significance of more than a billion dollars in agency self-reported past due accounts receivables, the SIG conducted a review of statewide accounts receivable programs, particularly the practices of collecting past due debt. Given the aggregate past due accounts receivables, opportunities to improve accounts receivable collections on a statewide basis could yield significance taxpayer savings in both bad debt avoidance, lower administrative handling costs, and enhanced cash flow management.

This review's objectives were:

- Survey a representative sample of agencies' accounts receivable programs to develop a baseline understanding of the operations of accounts receivable programs statewide;
- Identify accounts receivable best practices in state government; and
- Identify potential strategies to improve accounts receivable collections on a statewide basis.

B. Overview of Accounts Receivable

A substantial portion of the state's \$24 billion revenue came from Executive Branch agencies collecting for service fees, user fees, and taxes. Ideally, fees and taxes would be collected in advance, at time of a service, or due date set by regulation or statute. However, under many business models, this revenue is collected after the state provides a service. When this occurs, an agency establishes an accounts receivable for each debt. To effectively manage these accounts receivables, each agency creates an accounts receivable program through policies and procedures to manage establishing a customer account; invoicing (billing) a customer; and then builds a methodical process to collect the accounts receivable in a reasonable amount of time while incurring the least amount of administrative handling costs.

Despite the seemingly straight forward approach to operate an accounts receivable program, there are a variety of decision variables an agency makes to determine the optimal program to support its business model. These decision variables include: who and when to offer an accounts receivable versus requiring pre-payment or payment upon delivery; method of invoicing (email or US mail); payment terms; payment options; late fees; collection management process; personnel staffing of accounts receivable; use of a collection agency; and a bad-debt write-off policy. An accounts receivable program should develop simple metrics to measure its effectiveness, which then drives periodic re-evaluation of the program decision variables to continually improve debt collection and minimize the administrative handling costs.

III. Survey of Accounts Receivable Programs in the Executive Branch

This review started with an analysis of the 2013 Annual Debt Collection Report containing agencies' self-reported outstanding accounts receivable debt over 60 days on 12/31/2013, which totaled \$1,021,950,073 from 97 Executive Branch agencies (see Appendix A-1). Of the 97 agencies, 27 had aggregate debt of \$1.02 billion (99.96%) with the residual agencies' aggregate past due debt of \$500,000 (0.04%) (see Appendix A-2 for debt in descending order).

A review of the 2013 Annual Debt Collection Report raised concern with the accuracy and reliability of its data. Issues included: non-reporting by several agencies; did not include \$57 million past due debt from 16 agencies reported after the preparation of the report; agencies' accounts receivables passed to DOR for collection were double counted on both agencies' books; unclear guidance on reporting debt previously written-off, such as \$440 million at DOR; some agencies reported all accounts receivables rather than only debt in excess of 60 days as requested; some agencies limited accounts receivable to only the past 12 months; and a variety of other format issues. To enhance the accuracy and reliability of the upcoming 2014 Annual Debt Collection Report, the SIG has coordinated with the Executive Budget Office (EBO) to improve guidance and standardize reporting. The recommended standard is simple and straight forward—total accounts receivable over 60 days old still on an agency's books on 12/31/2014, and specifically exclude any previously written off debt. (see Appendix G for draft uniform report format).

The SIG interviewed a cross section of thirty state agencies to develop a baseline understanding of accounts receivable programs in South Carolina state government. The SIG determined a few agencies were exceptional, characterized by a very pro-active approach to policies, debt collection procedures, and metrics for results to drive continuous improvement, while others were complacent. Most agencies landed between these two extremes creating an overall bell curve of how state agencies managed accounts receivables, particularly collecting past due debt.

An example of a model accounts receivable program was found at the College of Charleston. The core of this successful program was based upon a continuous improvement model of management. The program developed policies, procedures, and workflows in sufficient detail to set clear expectations on how employees executed the program. Then, it did what poor programs fail to do---measured results, compared results to expectations, and modified the program to continuously improve. As an example, in 2005, 54% of the students were delinquent in their obligations prior to each semester's payment deadline. With modification in its accounts receivable process, only 3% in 2013 were delinquent at the same deadline. To demonstrate the proactive nature of this program, the University developed a procedure to annually rank its multiple collection agencies by each's rate of return and fees. These rankings determined the timing and amount of future accounts turned over to these companies for collection, which incentivized collections and lowered fees. In short, a continuous improvement accounts receivable model created a self-reinforcing process of standardized procedures with embedded metrics, which provided management the data to evaluate its program and continuously identify areas to improve.

Another example of excellence was the South Carolina Department of Parks, Recreation, and Tourism (PRT), which reported significant problems with bad checks in prior years. This agency completely solved this problem by refusing to accept checks and required payment by debit or credit card. This agency also created an online registration and payment system for reservations and merchandise.

Interestingly, agencies on the lower end of the effectiveness spectrum generally were all satisfied with their accounts receivable program. Obvious symptoms of shortcomings were manual processes; delayed initial billings; timid in collection approach for fear of angering constituents; and a claim their customers were unique causing unavoidable delinquencies and bad debt. One director stated his agency was never established to make money, which really crystallized the problem with low performing accounts receivable programs. Collecting what is due to the state is not making money; it is a critical business process to lower bad debt, lower administrative handling costs, and improve cash flow. Most importantly, anything less than a rigorous good faith effort to collect past due accounts receivables places an unfair burden on everyone else paying in a timely manner, most notably taxpayers.

Many agencies in the middle of the spectrum may not have had the mature accounts receivable program found at the College of Charleston, but they certainly proactively identified problems and developed solutions. Examples included one agency removed the 60-90 day column from its aged receivable report and thereby changed the internal perception that accounts could not exceed 60 days before collection. The result was all but three customers complied, which improved cash flow and lowered administrative handling costs. A second agency required pre-payment for services when the payer was geographically remote, thereby eliminating a receivable. However, this agency still invoiced local customers and still faced some issues with their local collections. Despite these agencies not having a classic continuous improvement program model characterized by defined success metrics, they did proactively manage their accounts receivable program to identify problems and develop solutions to move these agency's programs in the right direction with corresponding savings.

The main difference between the exceptional agencies programs from poor programs was a function of management's proactive efforts to identify problems or opportunity for improvements, all of which were in the direction of a continuous improvement model. A continuous improvement model self-reinforces management to seek excellence, while complacency puts programs on the course toward mediocrity or worse. The SIG has no reason to think lower performing accounts receivable programs were intentionally mismanaged. Rather, it is a function of all the symptoms of organizational ineffectiveness—complacency, lack of benchmarks, and inherent organizational inertia unaddressed by leadership. In short, not optimizing an accounts receivable program through fundamental management is pure government waste caused by poor management practices.

IV. Opportunities for Individual Agency Improvement By Applying Best Practices

The start for individual agency improvement is to develop baseline benchmarks to create a basis of comparison. This will identify areas for potential improvement. Identifying industry best practices is generally the foundation to establish baseline standards. Accounts receivable best practices can be summed up in a few conceptual steps: prevention; collect early and often; collect locally; and proactive persistence. Best practices were identified throughout the SIG's contact at 30 agencies, which were comparable to best practices in

management literature. Best practices do not always translate to every agency due to different business models, but it is the place to start an improvement initiative.

Improving an individual agency's accounts receivable program should not be viewed as a one-time comparison to best practices. Any group of policies and procedures require the development of metrics for success and periodic review. This, if managed proactively, in turn, creates a program capable of continuous improvement.

A. Prevention

The best way to collect on an accounts receivable is to prevent the creation of one in the first place. If possible, agencies should collect fees before or at the time of service delivery. In small business terms, this is called "getting your money up front." In today's marketplace, customers are used to paying for goods and services before taking ownership, particularly via debit or credit cards.

Agencies shifting to online payment methods was the common solution to this issue. The review did identify a number of current agency practices unnecessarily invoicing after a service despite the obvious potential of online payment options.

Several agencies rented out space but did not collect payments up front. At least one agency experienced collection of a past due accounts receivable when the renter was another state agency. A solution would be to require an interdepartmental transfer of funds prior to the rental.

A low dollar but common problem was agencies invoicing their cost for services associated with document requests, such as FOIA requests. Agencies have complete control to require payment at time of delivery to offset costs, but do not always do so. As way of example, the Department of Archives and History showed 40% of its accounts receivables were eliminated in just one year after implementing a pre-payment policy for records and research.

B. Invoice at Delivery

To meet an agency's business model, the fee or tax may not be collected at the time of service or by the due date. This review found several agencies that averaged over 30 days after delivery prior to sending out the initial invoice. The invoice should be remitted at delivery or as soon as possible in order to speed up the payment process. This both impacts an agency's cash flow and sets the tone for earlier payment. Further, the longer a receivable remains outstanding, the greater the likelihood it becomes an uncollectable debt.

C. Invoice Often

With collections, the adage, "The squeaky wheel gets the grease," has never been truer. Just as important as it is to invoice at delivery, following up quickly with past due notifications is essential to collections. If each collection contact is an opportunity to collect an outstanding balance, then frequent reminders create more

opportunities for payment. Agencies successful in this area exploit the inexpensive nature of email invoicing with the delivery receipt easily electronically confirmed.

D. Call Between Invoices

Placing a phone call to the customer to inquire on payment between invoicing periods serves as both a reminder for payment and a confirmation of receipt of the invoice. There is no reason to let the account sit between written notifications for late payment. Most private collection agencies have two methods to collect debt— letters and phone calls. Agencies can use these same techniques to improve collection and avoid referring debts to collection agencies and incurring additional fees. One finance director reported her team invoiced each month with phone calls at the midpoint between invoices, which reduced collection time.

E. Collect Locally

State agencies generally centralize accounts receivable in its headquarters for business accounting reasons. However, the best collection approach found was to de-centralize past due collection efforts to where the debt originated. Pushing out the collection efforts to be as close to the customer fixes responsibility with the agency employees directly working with the customer. Even if an agency chooses to send out invoices from a central location, involving agency employees with direct customer contact in the collection effort increased collections.

The Medical University of South Carolina (MUSC) conducted a Lean Six Sigma project to both reduce accounts receivable and improve cash flow for better financial planning. (See Appendix F) As part of this project, students were contacted more frequently about deadlines and balances due. Further, the individual colleges within the University were involved by being made aware of their students with past due receivables. This resulted in decreasing accounts receivable by \$525,637, a 61% reduction.

Perhaps the best example of fully exploiting this best practice, one agency made each department responsible for its own collections, which was incentivized by any bad debt being directly deducted from that department's budget. The effect was predictably positive for collections and the agency's cash flow. When ownership of collecting delinquent debt is fixed with front line employees who interact with customers, collections increase.

F. Late Payment Penalties and Collection Costs

Some agencies charged late payment fines and collection costs while others did not. Some agencies chose to not charge late fees while others reported their fees were set by statute, to include prohibiting late payment penalties or the ability to suspend activities for non-payment. Late payment penalties clearly incentivize meeting payment deadlines.

G. Exploit Technology

An accounts receivable program has many procedures that can be automated to increase collections and lower administrative handling costs. The best example is a secure online payment system that both gets payment up front and lowers administrative handling costs. Another example was an agency worked with the Division of Technology, BCB, to create an auto-call program and automatic email for delinquent accounts. The procedures of an accounts receivable program provide ample opportunity to exploit today's technology to improve a program's efficiency and effectiveness.

H. Doubtful Accounts Receivable Policy

Unfortunately, there comes a time in the collection process where the debt is determined to be uncollectable. When an agency writes debt off for accounting purposes, it may differ from when the agency stops collection efforts. Given the different state and federal statutes of limitations applying to different state agencies, it is not possible to create a statewide policy on the appropriate time to write off bad-debt. However, each agency should develop a policy to help control administrative handling costs. Examples of write-off time frames used by various state agencies include three years after no payment on the debt; applicable statute of limitations; and when judgments or liens of record expire.

I. Proactive Vigilance-Leadership

Building and managing an accounts receivable program requires evidence based judgment and a proactive mindset. One agency averaged a 30% bad debt write-off while another agency, with a completely different business model, averaged a 1% bad-debt write-off; both "felt" okay with this result. Who is right? The only way to know is to have a proactive accounts receivable program using a continuous improvement model, which would be able to provide a business case for the appropriate average bad debt write-off. An organization can't know if it is 'good enough' without establishing reliable standards in a rigorous manner. Complacent programs tend to stop at that comfortable "feels okay" threshold decision. Avoiding bad debt and lowering administrative handling costs are only limited by an agency's desire to be proactively vigilant using an evidence based management program that drives continuous improvement.

A good example was the South Carolina Department of Transportation (SCDOT) aggressively tracking down payment sources for known instances of damage to state property caused by vehicle accidents. SCDOT follows up with insurance companies for payment, and has arranged with the Department of Motor Vehicles to suspend the involved driver's motor vehicle license for non-payment. Another agency eliminated the use of checks and moved customers to online payment, which nearly eliminated bad debt and accounts receivable. Technical schools and universities keep a 'hold' on the account of a debtor even after the debt was written off, which prevents the debtor from doing business with the institution until the prior debt is collected.

A poor example would be several agencies incur costs, which were then referred to other agencies for collection. While this collection process conceptually was established for efficiency, the reality was collections were, at best, a perfunctory function at other agencies and, at worst, these funds were among the lowest

priorities for the collecting agency. The agency delegating its debt collection did not vigilantly monitor progress on its accounts receivables, which resulted in under-addressed past due accounts receivables, which will inherently lead to higher uncollectable debts.

With such a large statewide reported past due accounts receivables, a small percent in the reduction of bad debt and administrative handling costs can lead to a large taxpayer savings. Improving an accounts receivable program is basic fundamental management. The ingredient to spark this improvement is leadership which challenges processes and people with high expectations, while defeating complacency's attitude to be content with "good enough."

V. Opportunities for Improvement Through Statewide Strategies

A. Leverage SC Department of Revenue Collection Capabilities

Unique to South Carolina state government is our own internal collection agency, the South Carolina Department of Revenue (DOR). This agency's core mission is to collect funds on behalf of the state. In addition to tax collection, the agency has two collection programs which are available to all state agencies to promote collection of their past due receivables: the Tax Set-Off Program (Set-Off); and the Government Enterprise Accounts Receivable Program (GEAR).

Set-Off is DOR's best known program among state agencies. After appropriate notice by the agency, past due accounts receivables can be turned over to DOR once a year in the Fall. These past due accounts are then matched up against any tax refunds due a taxpayer. If there is a refund due, the balance due to a particular agency is off-set from the refund and remitted to the agency. DOR charges a fixed \$25 fee per refund set-off, which is collected from the taxpayer's refund if available (See Appendix C for a complete guide to Set-Off).

GEAR is the more intensive collection effort on the part of DOR. GEAR uses traditional collection methods found in the private sector, such as demand notices and telephone calls. However, it has a uniquely distinguishing capability to levy against assets and to garnish wages to satisfy the debt owed. This capability creates the leverage with debtors to normally respond to GEAR's initial demand without the need to move forward with a levy or garnishment. Other attributes of GEAR are:

- GEAR charges a 28.5% collection fee, which is deducted from the balance owed to the agency and is higher than private debt collectors ranging from 20-25%. GEAR is unable to add its 28.5% collection fee to the collection debt even when the agency has a legal basis to require a debtor pay collection costs. Using GEAR, even if the entire debt is recovered, the agency will only net 71.5% of the past due account balance. Agencies can submit past due accounts to GEAR throughout the year.
- Debt placed for collection in the GEAR program is also automatically placed in the Set-Off. DOR uses Set-Off as the recovery of first choice with the lower fixed fee of \$25. Those accounts not satisfied by Set-Off are then subject to GEAR's more rigorous recovery methods and charged the dramatically higher 28.5% collection fee. (See Appendix D for a complete guide to the GEAR).

Before an agency can avail itself to either Set-Off or GEAR to collect debts, the agency must exhaust all internal channels to collect the balance owed; any right of contest or appeal regarding the balance owed should be expired to satisfy due process standards; and the agency must send a notice to the debtor the account is being turned over to DOR for collection.

The SIG review identified five issues inhibiting state agencies from fully exploiting DOR's past due accounts receivable collection programs, which were:

- Many agencies did not have an accurate understanding of Set-Off and GEAR: Many agencies contacted were unaware of the programs available at DOR. Of the two, Set-Off was generally better known and utilized than GEAR. Many agencies did not understand the distinctions between the two programs or aware they had access to both programs. A common misunderstanding was that an agency could not continue collection efforts or to accept payment after an account had been turned over to GEAR where that could be done under Set-Off. DOR does allow payment to be collected by the agency in both programs after an account is turned over to DOR.
- GEAR's 28.5% fee was higher than the private debt collectors: GEAR's 28.5% collection fee was substantially higher than private debt collectors, which ranged from 20% - 25%. Many state agencies have opted to use private debt collectors over GEAR to save collection fees. According to DOR officials, the 28.5% rate was artificially set higher than private debt collectors at the inception of GEAR in 1997 to address claims of unfair competition by private debt collectors with existing state agency contracts. GEAR also represented itself as a collection effort of last resort, which tended to promote the use of private debt collectors to collect delinquent public debt.
- GEAR does not pass on its collection fees to debtors: Several state agencies using Set-Off opted out of using GEAR because GEAR could not pass on its collection fees (28.5%) to debtors even when the agency had a legal basis to require a debtor pay collection costs. Some agencies have established a legal basis with debtors to charge late fee penalties, which both incentivize on-time payment and serves as a cost recovery measure for the additional administrative handling costs. Also, some agencies operated under federal guidelines which precluded allowing for the collection costs to be deducted from the underlying accounts receivable debt, thus preventing these agencies from using GEAR.
- DOR requires taxpayer identification numbers on accounts submitted for collection: Some agencies do not have the debtor's taxpayer identification number, which prevents the agency sending the debt to Set-Off or GEAR. Another state agency has this information which, if shared, could increase collections. Rather than having each agency request this sensitive information before submitting accounts to DOR, there is a greater likelihood of accessing this data under highly controlled circumstances through just one agency, DOR, to simplify logistics and information security risks.

- DOR technology interface with agencies needed improvement: Several issues with data transmission mechanisms to DOR and format were raised. During the review, DOR addressed these concerns for both Set-Off and GEAR.

An example of the potential benefit of fully exploiting GEAR, an agency approached DOR regarding the handling of collections through GEAR. This agency requested concessions for a reduction of the 28.5% fee, as well as the need for GEAR to collect its late fees from the debtor inasmuch as the agency's debt was covered by federal regulations prohibiting collection fees being deducted from the underlying debt. DOR, at the time, was unable to accommodate the request. As a result, this agency is now proceeding with a separate Request for Proposal (RFP) for a private collection agency to handle this debt, which was well over \$100 million in past due accounts. If awarded, collection fees on this large debt will move out of the figurative state pot and into the hands of a private collection company. A review of the statewide procurement contract for higher education debt collection services identified 19 vendors; 17 vendors were out of state and two had South Carolina addresses.

Outsourcing an activity certainly makes sense when the activity can be handled more cost effectively or the organization doesn't have the capability to perform the activity. However, in the case of past due accounts receivable collections, the state has an agency specifically designed to handle this activity with unique capabilities not found in the private sector. Private sector collection companies are not to be discouraged, but state government should be given the first opportunity to collect its own debt and lower the state's collections costs if it can adequately compete. Additionally, allowing GEAR to be the first choice of agencies' collection efforts will result in GEAR having access to past due debt sooner to enhance collectability. Currently, many of GEARS past due debt comes after private sector companies have failed in collection efforts.

During the SIG review, DOR noted its interest in understanding how the agency, particularly GEAR, can better serve state agencies. DOR described the history of GEAR being considered the debt collector of last resort, which certainly played a role in the existing factors inhibiting agencies from using GEAR. DOR deemed it had some flexibility to address the issues identified inhibiting state agencies from fully exploiting GEAR, while some changes, such as adding its collection costs to the debt, will require legislative action. With seemingly modest modifications to GEAR, DOR could stand as the collection agent of first resort for all state agencies after exhausting their internal efforts, rather than the last. DOR should be able to lower its fees charged to state agencies after it recovers its fair costs, which, in turn, will incentivize agencies to use DOR for cost savings. Given its unique capabilities and potential significant collection cost savings to agencies and, correspondingly, taxpayers, GEAR should have the first opportunity to collect the state's debt as long as it is competitively advantageous over private sector collections agencies, many of which were out of state.

B. Statewide Mechanisms to Address Bad Checks

Almost every agency reviewed had some issue with checks returned for insufficient funds, ranging from five checks per year at one agency to another's entire accounts receivable composed of over a million dollars in returned checks. In addition to bad debt potential of these checks, many agencies commented on the corresponding administrative handling costs just to attempt to try to collect on a returned check.

If a check cannot be collected after proper notification, the proper venue in the private sector to enforce collection is usually a local Magistrate's court due to the small dollar amount involved. However, state agencies are prohibited from bringing an action to collect, under SC Code Ann. § 22-3-20, in Magistrate's court. As a result, a state agency can't enforce a collection action except in the Court of Common Pleas which has significantly higher fees and higher thresholds.

Only two agencies in this review used Worthless Check Units (WCU) in local Solicitor's offices to address bad check debt; both agencies reported positive results. Writing a bad check is an unlawful act under SC Code Ann. §34-11-60 (a). Almost every state Solicitor's office has a WCU with a reported recovery rate ranging between 60%-80%. There is no cost to an agency and the WCU takes care of all notices to the offender. The fees charged by the solicitor's office are added to the check balance, so the agency is made whole. All this is done on a very simple WCU form with the check attached (see Appendix E).

Agencies' difficulties in dealing with checks included:

- Several agencies wanted a check verification system, which would immediately determine if a check was good or not, but determined their check volume was insufficient to warrant the expense of such a system;
- Several agencies reported that most of their insufficient fund checks came from businesses or organizations, which many check verification systems did not cover;
- One agency had an entire revocation process with hearings that had to be followed if someone paid with a worthless check;
- Other agencies, per their legal counsel, had no statutory authority to revoke a license or filing, even if the check presented for the license had insufficient funds; and
- Several agencies were hesitant to intensely pursue collection of bad checks for fear of citizen pushback impacting their constituent service reputation.

The best solution to this problem is by simply refusing to take checks, which one agency has successfully used. Given the advent of paperless payment systems with paper checks on the decline, this may be an option for other agencies in the future. In the meantime, possible statewide strategies include a legislative change allowing state agencies to bring an action to collect in Magistrate's court and agencies utilizing WCUs in local Solicitor offices.

C. SC.Gov

SC.Gov, also known as SC Interactive, hosts many state agency websites at no cost. SC.Gov can set up an online payment system for an agency. Agencies have no out of pocket expense for this service, but SC.Gov

does add a transaction fee. Many agencies have modified regulations to allow passing this transaction fee on to the customer. SC.Gov can also automate customer data submitted with a payment, at no charge, which would eliminate manual processing by the agency. When interfaced with an agency's billing application, the process can also be set up to disallow late filings without a late fee being charged.

As an opportunity to leverage SC.Gov, two agencies were identified with past due accounts receivables almost entirely made up of late filing fees, which could be eliminated by using SC.Gov. A second example pertained to two small schools having almost identical business models, yet one used SC.Gov to electronically handle payments up front and online, while the other invoiced for payments due. The school not using SC.Gov had accounts receivables while the other using SC.Gov had none.

D. Leveraging Multi-Agency Capabilities

Many examples were identified where cooperation among agencies created leverage to more effectively collect past due accounts payables. Examples included:

- SC Business One Stop (SC BOS) is an online interface through DOR allowing business owners to file forms and make payments to many state agencies. This creates a single entry point for the business to be able to submit both data and payments to many agencies, to include the Secretary of State, the Department of Employment and Workforce, Consumer Affairs, DOR, and many others.
- A retailer cannot obtain a lottery license until all delinquent sales tax was paid;
- Several agencies queried the Department of Health and Environmental Control's death certificate database, which allowed for a more timely termination of state benefits and a prevention of an accounts receivable; and
- Each vendor doing business with the State is issued a unique code number through SCEIS. Once a business has been levied by DOR for unpaid debt, the Comptroller's Office manually blocks payments to that business and any funds are re-routed to DOR to satisfy the debt.

The review also identified situations where agencies possess unique data, which if made available to other state agencies, could enhance the effectiveness of accounts receivable collections and many other potential efficiencies. A good example was an agency had a database containing essentially all relevant identifiers for most residents of South Carolina. Access to that database by other state agencies had the potential benefit of obtaining information to enhance other agencies' collection capabilities. Another example was a number of agencies desired to access the Department of Labor, Licensing, and Regulation's (LLR) employment verification database, E-Verify, to enhance identifying benefit recipients quickly whose benefits should be stopped due to obtaining employment. Access to this database would be extraordinarily helpful, but current federal Homeland Security regulations prevent sharing this information.

The challenge in developing these reciprocal leveraging benefits are the inherent complexities of information security risks, additional costs of providing information, and restraints from sharing based on state or federal regulations or laws. An ad hoc approach among sister state agencies should be encouraged. However, a better approach to stimulate systematic improvement would be to develop a central strategic view to better assess the costs/benefits of such information sharing arrangements, so the long-term benefits can be shared broader and prevent developing an ad hoc patchwork of individual arrangements. For example, many bad checks cannot be turned over to Set-Off because the agency lacks the Social Security number of the debtor, yet one state agency has the capacity to provide this information from its data base. Having one agency, such as DOR, interface with this one state agency would be much more feasible, from both efficiency and information security, than 100 Executive Branch agencies making independent requests. The SIG suggests development of DOR's programs to have a more central role in statewide accounts receivable collections may provide the platform to understand other potential leveraging opportunities.

VI. Way Forward

The difference between exceptional and mediocrity in any function of government, to include accounts receivable, is management's skill at building a program that measures results, which are then fed back into a program to stimulate a continuous improvement and an accountability mindset by the program's operators. A finance director of an exceptional program provided a great analogy viewing the accounts receivable collection process as a series of waterfalls. At each level, there was the opportunity to collect funds where employees proactively worked to maximize the opportunity; this same agency measured results throughout the organization so employees realized their efforts will ultimately be a reflection of their individual or unit's contributions. Lesser programs had less collection steps and less of a performance link with results, to include instances of agencies giving the appearance of just going through the motions. Surprisingly, some agencies did not push enforcement of collections out of fear of causing constituent complaints and possible repercussions. Certainly, the state must be professional and practical in collections to avoid unnecessarily alienating citizens, but by ignoring these accounts, or treating them softly, an inherent burden is placed on everyone else that paid their fair share.

Even a small improvement in both prevention of bad debt and lowering administrative handling costs on a large number in past due accounts receivables leads to significant taxpayer savings; a small percent of a big number can be a big number. As an interim step until the Department of Administration is fully developed, the SIG will facilitate and stimulate statewide improvement by annually organizing agencies' annual accounts receivables over 60 days, also known as past due, and place the data on its web page. Agencies will be able to track their year to year improvements, as well as compare their results to other agencies with similar business models and customers. The management adage of, "what gets measured gets improved," is quite applicable to moving statewide accounts receivable practices forward to yield taxpayer savings.

VII. Findings & Recommendations

Finding #1: The effectiveness of agencies accounts receivable programs varied statewide on a spectrum from excellence to complacency with very few programs having success metrics, all of which indicated an opportunity for statewide improvement through improving individual agency accounts receivable programs.

Recommendation #1a: Agencies should compare their respective accounts receivable programs to best practices to identify potential opportunities to improve based on each agency's unique business model.

Recommendation #1b: Agencies should require their respective accounts receivable programs adopt a continuous improvement model of identifying success metrics for periodic evaluation and feedback to the program to stimulate continuous improvement.

Finding #2: The 2013 Annual Debt Collection Report of agencies' accounts receivables in excess of 60 days produced data with accuracy and reliability concerns.

Recommendation #2: The Executive Budget Office, Department of Administration, should assume ownership of the Annual Debt Collection Report and improve the format to increase the accuracy and reliability of the data to measure statewide progress, as well as provide feedback and lessons learned on an annual basis.

Finding #3: The DOR Set-Off and GEAR programs were under-exploited and provided unique opportunities for statewide improvement to all agencies' accounts receivable programs.

Recommendation #3a: DOR should consider improving its communication strategy to inform state agencies about the capabilities of the Set-Off and GEAR programs and change its marketing posture to be state agencies collection agency of first resort rather than last.

Recommendation #3b: DOR should consider recovering GEAR's fair costs and then lower its fees charged to state agencies, which, in turn, will incentivize agencies to use DOR for cost savings.

Recommendation #3c: DOR should consider allowing, which will require legislative approval, GEAR to add its collection fee to the debt owed, thereby passing the cost of collections to the debtor rather than the state agency.

Finding #4: State agencies ability to efficiently collect bad check debt was hampered by state law (SC Code §22-3-20) preventing State agencies' ability to bring an action to collect in Magistrate's court.

Recommendation #4: The legislature should consider amending state law (SC Code §22-3-20) to allow state agencies to bring small collection matters in Magistrate's Court for the collection of debts or to enforce collection on bad checks.

Finding #5: Several agencies chose not to add late penalties or collection costs or were not allowed due to state policy, regulation, or statute, thus taxpayers absorbed the costs of collecting on past due accounts, including the costs of collection agencies.

Recommendation #5: Agencies should review their appropriate policies, regulations, and statutes, and consider amending same to allow for the addition of reasonable collection costs for past due accounts.

Finding #6: A small percentage of agencies interviewed referred bad checks for collection to their local Solicitor's Worthless Check Units, which essentially was a free and effective collection service.

Recommendation #6: Agencies should consider using their local Solicitor's Worthless Check Unit to assist with collection of bad checks.

Finding #7: Not all agencies interviewed had a written policy when a debt was deemed uncollectable.

Recommendation #7: Agencies should review their accounts receivable policies and amend, if necessary, to establish a uniform method for writing off bad debt, both from an accounting and collection perspective.

Finding #8: Agencies have developed information sharing initiatives with other State agencies which have enhanced the prevention of bad debts and lowered administrative handling costs.

Recommendation #8a: Agencies should consider opportunities to improve their prevention and collections of accounts receivables through information sharing with other State agencies.

Recommendation #8b: The DOR, as a central component of statewide accounts receivables, should seek to identify and stimulate potential information sharing arrangements that benefit statewide prevention and collections of accounts receivables.

Finding #9: The vast majority of state agencies reviewed did not develop accounts receivable success metrics which serve as the foundation for a program to sustain continuous improvement.

Recommendation #9: The SIG will aggregate, organize, and disseminate the results of the Annual Debt Collection Report to facilitate and stimulate statewide improvement of agencies' accounts receivable programs, which will allow agencies track year-to-year improvements, as well as compare their results to other agencies with similar business models and customers.

List of Appendices

(link: http://oig.sc.gov/Documents/Appendices_SIG_Accounts_Receiveable_Report.pdf)

- A. 2013 Annual Debt Collection Report
 - A-1: Sorted by Agency
 - A-2: Sorted by Amount
- B. 2012 Annual Debt Collection Report
- C. 2015 DOR Debt Setoff Package
- D. 2015 DOR GEAR Package
- E. Worthless Check Units in South Carolina
- F. MUSC Lean Receivables Project
- G. Draft Uniform Agency Debt Collection Report
- H. Contact Information