

## **Franchise Tax Board:**

*Significant Program Changes Are Needed to Improve Collections of Delinquent Labor Claims*



May 2004  
2003-131

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# CALIFORNIA STATE AUDITOR

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May 13, 2004

2003-131

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the process used by the Franchise Tax Board (board) to collect delinquent fees, wages, penalties, costs, and interest (claims) referred by the Department of Industrial Relations (Industrial Relations).

This report concludes that the board's success in generating collections for these claims is limited. Specifically, our analysis of 310 claims filed in fiscal years 2001-02 and 2002-03 shows that Industrial Relations received payment on only 20 percent of them. Furthermore, our review of 60 claims shows that, as of February 2004, the board has taken an average of almost 18 months to process these claims, and it still has not completed processing many of them. Between 2001 and 2002 the board conducted two studies to improve its collection activities by automating its system, however, the board abandoned the project after realizing it would not receive the additional funding to implement the changes. Although state law requires Industrial Relations to adopt rules and regulations to charge the employer a fee to cover the board's collection costs, it currently does not do so. By charging such a fee, the board and Industrial Relations could use the fees to automate the collections process and pay for additional staff.

Respectfully submitted,

A handwritten signature in cursive script that reads "Elaine M. Howle".

ELAINE M. HOWLE  
State Auditor

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# SUMMARY

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## *Audit Highlights . . .*

*Our review of the Franchise Tax Board's (board) collection activities in connection with delinquent fees, wages, penalties, costs, and interest (claims) referred by the Department of Industrial Relations (Industrial Relations) found the following:*

- The board's success in generating collections for these claims is limited—our analysis of 310 claims filed in fiscal years 2001–02 and 2002–03 shows that Industrial Relations received payments on only 20 percent of them.*
  - Further, our review of 60 claims shows that, as of February 2004, the board has taken an average of almost 18 months to process these claims, and it still has not completed processing many of them.*
  - The board conducted two studies to improve its collection activities by automating its system, however, the board abandoned the project after realizing it would not receive the additional funding to implement the changes.*
  - Although state law requires Industrial Relations to adopt rules and regulations to charge the employer a fee to cover the board's collection costs, it currently does not do so.*
- 

## **RESULTS IN BRIEF**

**T**he Franchise Tax Board (board) is one of the State's two major collection agencies. In addition to administering the personal income tax, corporation tax, and homeowner and renter assistance programs, the board assumes the collection responsibilities of other state entities. Chapter 1117, Statutes of 1994, Senate Bill 1490 (SB 1490), authorized the board to collect the delinquent fees, wages, penalties, costs, and interest (claims) owed to the Department of Industrial Relations (Industrial Relations) under the Labor Code. Many of the claims that Industrial Relations refers to the board involve an employer owing a wage earner unpaid wages; if Industrial Relations collects those wages, it passes them on to the wage earner. According to Industrial Relations, the claims that the board processes involve money owed to individuals from all walks of life including minimum-wage earners, commissioned salespeople, data engineers, and others. Clearly, these individuals would benefit by receiving the funds that their former employers owe them. Furthermore, Industrial Relations also refers claims to the board that involve penalties related to certain labor law violations that, when collected, are deposited in the State's General Fund or two other special funds. In light of California's current fiscal problems, the State would benefit from any additional revenues the board can generate.

We analyzed 310 Industrial Relations claims filed in fiscal years 2001–02 and 2002–03 and found that the board collected only 20 percent of them. The board often takes a significant amount of time to process these claims, and we believe it could be more successful if it responded more promptly to the cases Industrial Relations refers. The board took an average of over a year to process these 310 claims and longer than two years to complete six of them. Furthermore, our review of a sample of claims selected to determine where the delays occur in processing suggests that the board's process takes even longer, with the processing of 60 claims averaging almost 18 months by the end of February 2004, and many are still not completed.

Although the board's general fund and the Department of Motor Vehicles provided funds to automate two other collection programs, its collection of delinquent child support payments and vehicle registration fees, the board still manually inputs the claims that Industrial Relations refers to it into the Non-Tax Debt Consolidated Debt Collections system. Automated systems both speed up the process and use fewer staff to generate more dollars collected. Between 2001 and 2002 the board conducted two studies—a program proposal and a feasibility study—to improve its collection activities, decrease the substantial backlog in SB 1490 claims, and possibly increase resulting revenues. However, after realizing that it would not receive additional funding to implement the changes these would require, the board abandoned the project.

Three other states we reviewed operate collection programs similar to the SB 1490 Program and currently have or are working on implementing some level of system automation. One of these states retains a percentage of the amount collected on behalf of the wage earners to cover its own collection costs and the costs of sending the claims to a collection agency. We believe that charging employers a fee for the board's collection services is consistent with the language of SB 1490 and would clearly benefit California's wage earners, as well as the State.

## **RECOMMENDATIONS**

To monitor the amount of time the board takes to process claims and discuss any concerns when the delays seem excessive, Industrial Relations should require the board to periodically provide it with a status report on individual claims.

If the administration is unwilling to provide the additional resources needed to ensure that the board processes claims from Industrial Relations more promptly, Industrial Relations should consider taking the following actions:

- Adopt rules and regulations to charge a fee, as state law requires, to employers that delay paying their claims; the board and Industrial Relations could use such funds to automate the current system and increase staffing levels as needed.
- Prepare a cost analysis to determine the appropriate fee to charge employers that delay paying their claims.

## **AGENCY COMMENTS**

The board indicates that it agrees with our recommendations. However, Industrial Relations does not agree that it retains responsibility for monitoring claims after it has referred them to the board. ■

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# INTRODUCTION

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## BACKGROUND

The primary function of the Franchise Tax Board (board), one of the State's two major collection agencies, is to administer the personal income tax, corporation tax, and homeowner and renter assistance programs. In some cases, the board also assumes the collection responsibilities of other state entities, including delinquent vehicle registration fees for the Department of Motor Vehicles, child support payments on behalf of county district attorneys for the board's Child Support Collections Program, and delinquent money owing to the Department of Industrial Relations (Industrial Relations) under the Labor Code.

## INDUSTRIAL RELATIONS COLLECTIONS TRANSFERRED TO THE BOARD IN 1995

Chapter 1117, Statutes of 1994, Senate Bill 1490 (SB 1490), created the Joint Enforcement Strike Force on the Underground Economy (strike force). The purpose of this strike force was to address problems with the underground economy specifically related to noncompliance with the Labor Code. SB 1490 also mandated an agreement between Industrial Relations and the board, authorizing the board to use its administrative collection remedies to garner delinquent money owed to Industrial Relations as a result of unsatisfied judgments under the Labor Code beginning in July 1995. Industrial Relations is responsible for administering labor laws and hearing claims from wage earners regarding injury, illness, or safety hazards on the job. Industrial Relations also processes wage earners' claims against employers for unpaid wages or other compensation that falls under the jurisdiction of the state labor commissioner. The board can use its administrative collection remedies to collect delinquent fees, wages, penalties, costs, and interest (claims) as if they are personal income tax debt.

As a result of the agreement that SB 1490 mandated, the board established the Industrial Health and Safety Collection Program (IHSC Program). To fund this program, the board entered into a contract with Industrial Relations; the contract for fiscal year 2003–04 was for \$100,000. Industrial Relations primarily refers

wage claim adjudications and claims from its Bureau of Field Enforcement to the IHSC Program. Wage claim adjudications involve an employer owing wage earners unpaid wages; when collected, Industrial Relations passes the money to the wage earner. During fiscal years 2000–01 to 2002–03, according to the board’s records, it processed claims that resulted in wage collections totaling more than \$1.8 million. The Bureau of Field Enforcement is responsible for investigating and enforcing the statutes covering workers’ compensation insurance, child labor, cash pay, unlicensed contractors, public works, and industrial-welfare commission orders, as well as group claims involving minimum wage and overtime. The funds collected related to these claims are placed in the State’s General Fund, the Uninsured Employers’ Fund, and the Industrial Relations Construction Industry Enforcement Fund. During fiscal years 2000–01 to 2002–03, according to the board’s records, it has processed claims that resulted in collections totaling more than \$1.3 million for these three funds.

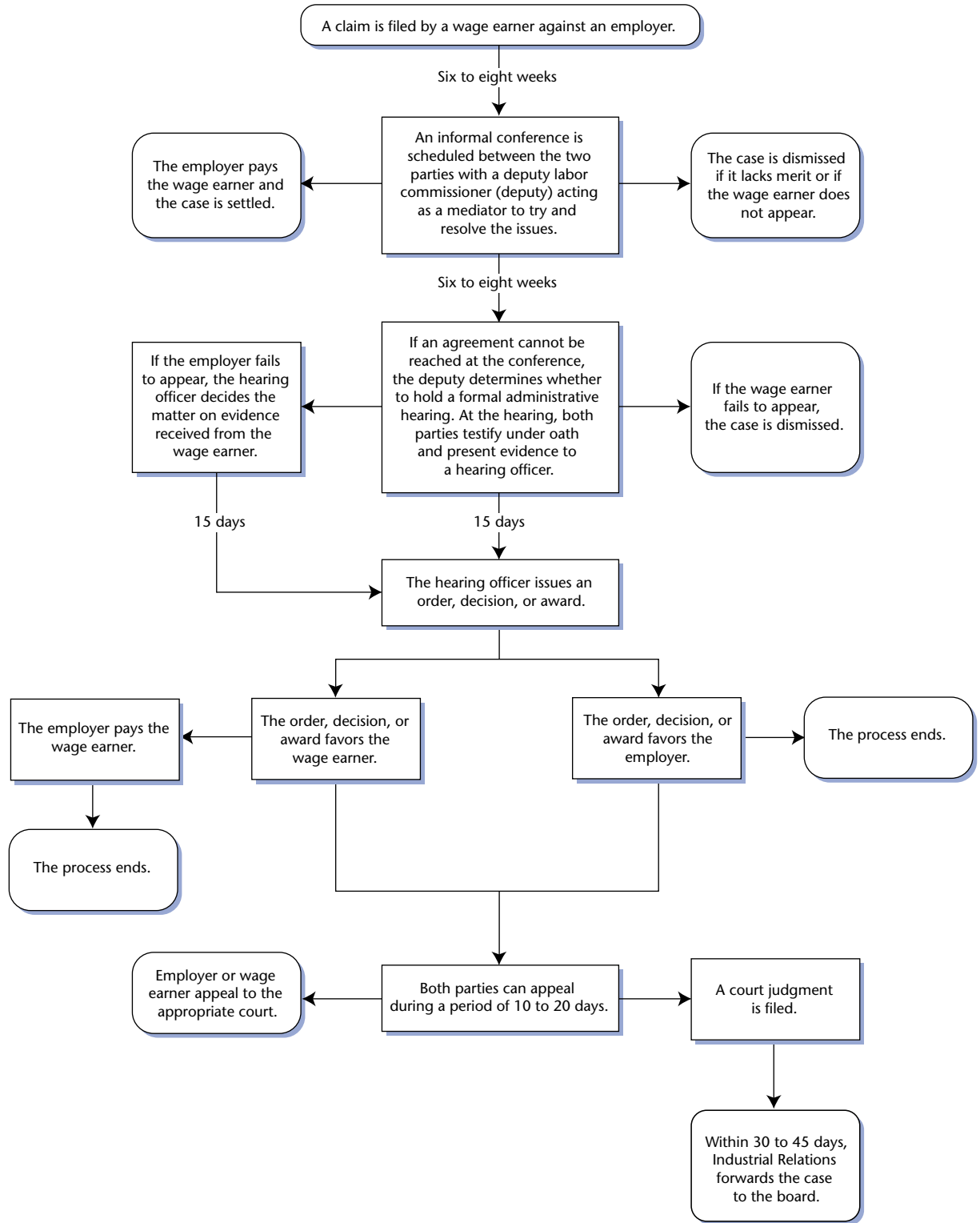
Subsequent to the passage of SB 1490, Chapter 33, Statutes of 1995, Senate Bill 996 (SB 996), mandated that Industrial Relations also levy assessments and penalties on employers, either self-insured or with workers’ compensation insurance, who have the worst safety records and the most preventable accidents. In response to this law, the board entered into a second contract with Industrial Relations, which for fiscal year 2003–04 was for \$75,000. Industrial Relations deposits revenue generated from this program into the California Occupational Safety and Health Act Targeted Inspection and Consultation Fund. The board handles the SB 996 claims under its IHSC Program as well. Although the Legislature did not request that we examine the SB 996 claims, our report refers to these claims several times because the board includes both collection programs in the studies that we describe in the Audit Results section of this report.

## **THE INDUSTRIAL RELATIONS COMPLAINT PROCESS**

Any wage earner who has a claim against his or her employer or former employer for unpaid wages or other compensation may file a claim with Industrial Relations. Industrial Relations adjudicates wage claims, investigates discrimination and public-work complaints, and enforces Labor Code statutes. Figure 1 illustrates the steps generally used in processing labor claims.

FIGURE 1

### Department of Industrial Relations' Procedures for Processing Labor Claims



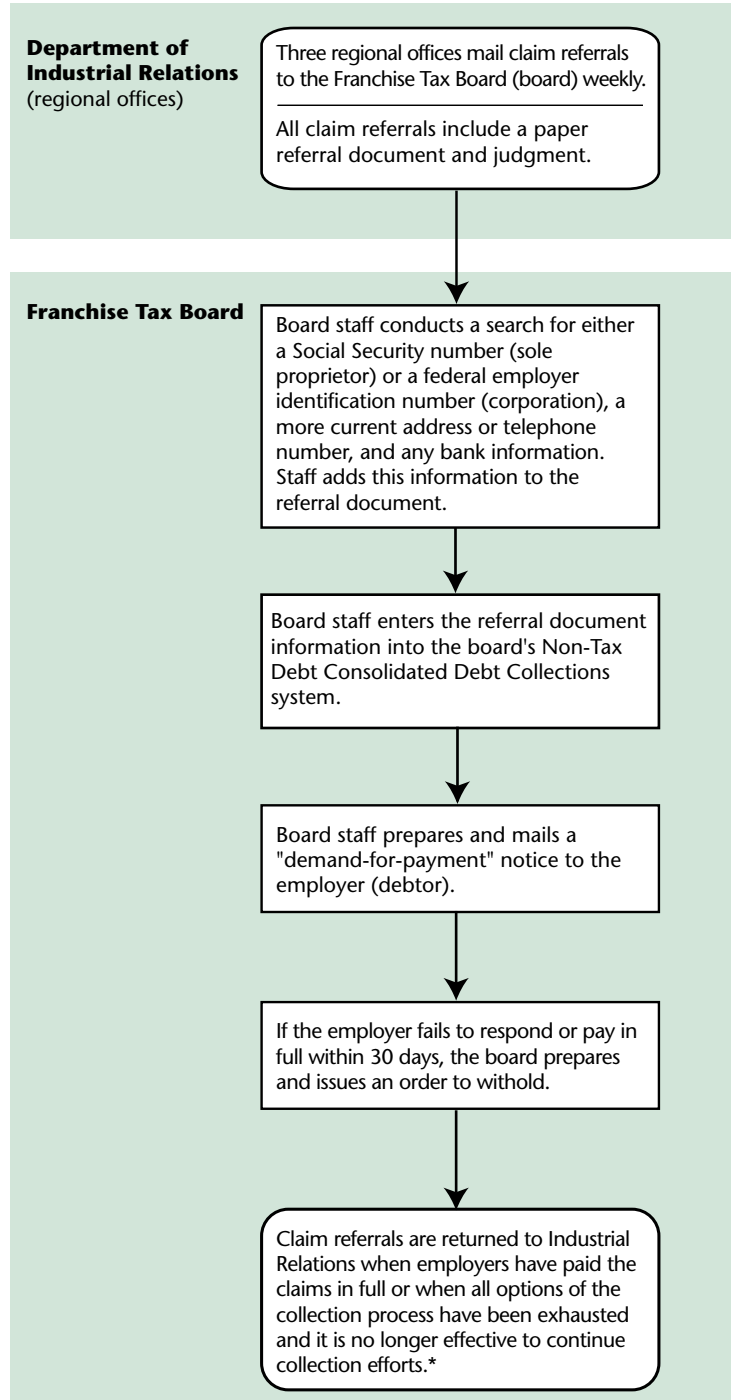
Industrial Relations actually processes the labor claims, as previously shown in Figure 1, at 18 field offices throughout the State. The field offices forward labor claims for consolidation to one of three regional offices: the field offices in northern California send claims to the Sacramento regional office, and the southern California field offices send claims to either the Santa Barbara or Santa Ana regional office. Ultimately, any funds collected as a result of board actions are submitted directly to Industrial Relations' three regional offices. Industrial Relations distributes payments to wage earners and notifies the board to end its collection activities.

### **THE BOARD'S PROCESS FOR COLLECTING CLAIMS ON BEHALF OF INDUSTRIAL RELATIONS**

According to the board's procedure manual, the collection process begins when one of Industrial Relations' three regional offices submits its weekly referrals of claims to the board, as shown in Figure 2. Each referral contains information about the employer, the name and phone number of the Industrial Relations deputy labor commissioner in charge of the claim, and the judgment amount against the employer. A board employee manually inputs the date and origin of each referral into a log. A second employee manually inputs information pertaining to each claim into the board's Non-Tax Debt Consolidated Debt Collections (CDC) system. Subsequent to inputting the claim into the CDC system, the board mails a demand-for-payment notice with an order to remit payment to Industrial Relations. If the employer pays in full, Industrial Relations notifies the board to stop all collection actions. If the employer does not remit payment to Industrial Relations within 30 days, the board issues an order to withhold, which attaches funds in checking and savings accounts, certificates of deposit, funds in escrow, individual retirement accounts, Keogh plans, credit union share accounts, or any other credits or personal property belonging to the depositor. According to the board's program manager, the board generally processes these claims on a first-in, first-out basis.

**FIGURE 2**

**Franchise Tax Board Procedures for Processing Labor Claims**



\* The board returns claim referrals for the following reasons: claim is paid in full, employer files for bankruptcy, Industrial Relations or the wage earner requests a return of the claim, employer has no assets available, or the board is unable to locate the employer.

## **INDUSTRIAL RELATIONS STILL ENGAGES IN SOME COLLECTION ACTIVITIES**

According to the assistant chief labor commissioner, the field office in Bakersfield still engages in the same collection activities that all Industrial Relations field offices followed before the enactment of SB 1490. The senior deputy labor commissioner also told us that the Bakersfield office has historically made collection efforts a part of the deputy's responsibility; because the Bakersfield office is smaller than the majority of the offices, this allows staff to spend more time on these activities. The steps that this field office takes compared with actions that the board pursues differ in two key ways. First, according to the senior deputy labor commissioner, the Bakersfield office can pursue a collection action against an employer only if it knows that the employer has assets that can be levied. In contrast, the board has access to several state databases that it can search to determine whether the employer has any assets. Second, if the employer is known to have assets, such as bank accounts, the field office must request a writ of execution from the superior court. Once the superior court grants the writ of execution, the Bakersfield office contacts the appropriate sheriff's office and instructs it to seize the specified assets. In contrast, the board has the administrative authority to issue bank levies on its own and does not need to obtain a writ of execution. Finally, according to the senior deputy labor commissioner, if the Bakersfield office cannot collect the balance of the judgment through the means at its disposal, it then forwards the claim to the board.

## **SCOPE AND METHODOLOGY**

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review the board's collection activities in connection with delinquent fees, wages, penalties, costs, and interest (claims) that Industrial Relations referred to it. Specifically, the audit committee asked us to review the board's policies and procedures for its collection activities, including the process it uses to track the status of collected and uncollected claims. The audit committee also asked us to evaluate the effectiveness of the process used by the board to collect claims. In addition, the audit committee asked us to determine the amount of time the board takes to collect claims, and if possible, to determine the average time between referral, action, and payment to wage earners. Furthermore, the audit committee asked us to identify the level of resources the board has for collecting claims and determine whether this level is

sufficient for the required workload. Finally, we were asked, to the extent possible, to compare the effectiveness of the board's current collection process to both Industrial Relations' process before SB 1490 and other states' collection processes.

To understand the board's process for collecting and tracking claims, we interviewed its staff and reviewed its policies and procedures. We also interviewed various staff at Industrial Relations to gain an understanding of how it processes complaints before referring them to the board.

To evaluate the effectiveness of the board's collection process, the audit committee requested that we determine the average amount of time the board takes to collect claims by using dates related to referral, action, and payment to wage earners. However, because of significant limitations in the electronic data that both the board and Industrial Relations provided to us, we were limited in our ability to calculate this type of information. Because we were able to obtain electronic data that provided only the date Industrial Relations sent a claim to the board and the date that the board returned the claim for those claims that Industrial Relations' northern California field offices processed, we were able to calculate an average related to these claims only. Otherwise, we were limited to selecting a sample of 60 claims and obtaining various dates by reviewing paper files and searching several disparate data files.

To assess whether the level of resources the board has is sufficient to handle the workload, we interviewed board staff and reviewed expenditure and payroll reports to determine the number of staff assigned to work on this program. In addition, we analyzed the expenditures the board charged to the contract to determine the reasonableness of those costs.

Finally, we were unable to compare the effectiveness of the board's current collection process to Industrial Relations' process in effect prior to SB 1490 because Industrial Relations did not retain collection statistics from before 1995. Instead, we interviewed staff at the board who are responsible for processing delinquent child support claims and Department of Motor Vehicles delinquent vehicle registration fees and compared the board's processes for those two programs to its process for collecting claims under the SB 1490 Program. Finally, to compare the board's collection process to those of other states, we obtained information related to processes for similar collections programs in the states of Oregon, Texas, and Washington. ■

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# AUDIT RESULTS

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## **THE BOARD'S DELAY IN PROCESSING CLAIMS MAY HARM CALIFORNIA WAGE EARNERS**

Chapter 1117, Statutes of 1994, Senate Bill 1490 (SB 1490), required the Franchise Tax Board (board) to collect the delinquent fees, wages, penalties, costs, and interest (claims) that result from labor law violations by California employers. The Department of Industrial Relations (Industrial Relations) may refer claims to the board that have met all the following criteria: (1) the employer failed to pay the claim within 30 days; (2) Industrial Relations followed its process for determining the validity of the claim; and (3) Industrial Relations filed the appropriate court documents. Many of these claims involve wages that employers owe to California's wage earners. According to Industrial Relations, the claims the board processes involve money owed to individuals from all walks of life, including minimum-wage earners, commissioned salespeople, and data engineers. Clearly, these individuals would benefit from receiving those funds as quickly as possible.

### **The Board's Success Rate in Collecting Money on Industrial Relations Claims Is Limited**

After analyzing 310 claims from Industrial Relations' northern California field offices that the board completed processing during fiscal years 2001–02 and 2002–03, we found that the board had only limited success in generating collections from these claims. Industrial Relations received either full or partial payment on only 20 percent of them. Further, the board took an average of just over one year to process them. We believe the board could be more successful if it responded to these cases more promptly; according to the board's program manager, delays in processing the claims may result in the board losing the opportunity to collect money from employers who ultimately close down their businesses and disappear. We discuss these claims in greater detail below.

Furthermore, our review of a sample of 60 claims selected to determine where the processing delays occur confirms that the board does not resolve these claims promptly. As of the end of February 2004, the average time the board has been processing these claims was almost 18 months, and the board still has not

completed many of them. In fact, 13 of these claims have been with the board longer than two years. We discuss our review of this sample in further detail below.

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*California's wage earners may be harmed by the board's delay in processing claims. In addition, the State's General Fund and two special funds may lose a portion of the revenues they might otherwise collect from claims referred to the board.*

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The board's delay in processing claims may harm California's wage earners; in addition, the State's General Fund and two special funds may lose a portion of the revenues they might otherwise collect from claims that Industrial Relations' Bureau of Field Enforcement refers to the board. Clearly, in light of California's current fiscal problems, the State benefits from any additional revenues the board can generate.

The board's program manager pointed out that delaying processing of some claims can be beneficial because, with the older claims, employers may have had time to establish a new business, become employed, or acquire additional assets, which they may not have had when the claim was first established. In this circumstance, the board could have greater success in generating collections because it delayed processing the claim. However, this suggests that the board could more successfully generate collections not only by processing claims more promptly but also by Industrial Relations periodically resubmitting unpaid claims for processing, which currently it does not consistently do.

### **The Board Has a Backlog of Claims**

According to the board's program manager, the lack of funding to automate the board's computer system and assign adequate staff has resulted in substantial delays in its ability to process claims promptly. The program manager told us that, as of February 2004, the board's Non-Tax Debt Consolidated Debt Collections (CDC) system contains 6,187 claims that are categorized as open or still in progress; these claims have judgment amounts valued at a total of over \$47 million owed to wage earners or the three state funds. This is in addition to the 1,597 claims that staff told us the board received between August 2003 and February 2004, but had not yet entered into the CDC system. In total, the board has 7,784 claims that require processing as of February 2004. The board's records indicated that it received 3,015 claims from Industrial Relations in fiscal year 2001-02 and 3,421 claims in fiscal year 2002-03. According to the program manager, because only one employee is assigned to process these claims and the board's computer system does not allow for automatic processing of claims, the board does not have sufficient resources to effectively reduce

the large number of claims in progress, thereby adding to the average amount of time that a wage earner must wait to receive payment or to be informed that a payment cannot be made because the board could not locate the employer's assets.

### **The Board on Average Took More Than a Year to Process and Return Claims**

As shown in Table 1 on the following page, the board took an average of 391 days to process Industrial Relations claims.

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*Only 20 percent, or 63 of 310 claims that the board completed processing and returned to Industrial Relations generated collections.*

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We analyzed all the claims that Industrial Relations' northern California field offices referred to the board through its Sacramento regional office during fiscal years 2001–02 and 2002–03. The board had completed processing and returned only 310 of these 1,950 claims as of June 30, 2003. Only 20 percent, or 63, of the 310 claims generated collections. The board processed the claims in as few as eight days but took more than two years to return six claims to Industrial Relations. The claim that was with the board for only eight days showed that the employer was bankrupt, resulting in no payment to the wage earner; another wage earner received his payment more than three years after Industrial Relations referred his claim to the board. Of the 1,950 claims, 1,640 remain at the board without resolution. Thus, the number of days that the board takes to process these claims could take even longer than the average indicated for the 310 claims it processed and returned to Industrial Relations by the end of fiscal year 2002–03.

### **Entering Claims Into the System Accounts for a Significant Portion of the Processing Delay**

To gain a basic understanding of the amount of time involved between the individual steps of the claim collections process, we selected a sample of 60 claims that Industrial Relations referred to the board during fiscal years 2001–02 and 2002–03. Table 2 on page 17 summarizes the results of our review of these 60 claims, and the Appendix provides the details.

The Franchise Tax Board Took an Average of 391 Days to Process Claims It Received From the Department of Industrial Relations During Fiscal Years 2001–02 and 2002–03

Field Office From Which Claims Were Received	No Payment Received			Payments Received*			Total Claims Returned to the Department of Industrial Relations (Industrial Relations)				
	Number of Claims Completed	Percentage of Claims Completed†	Average Days With the Franchise Tax Board (Board)	Number of Claims Completed	Percentage of Claims Completed†	Average Days Claims Were the Board	Dollar Value of Payments	Number of Claims Completed	Percentage of Claims Completed†	Average Days Claims Were With the Board	Total Number of Claims Referred
Bakersfield	21	18.7%	363	5	4.5%	230	\$ 4,840	26	23.2%	337	112
Fresno	36	12.8	378	13	4.6	386	144,622	49	17.4	380	281
Oakland	28	10.5	342	2	0.7	354	5,612	30	11.2	343	267
Sacramento	40	13.1	427	13	4.3	374	39,319	53	17.4	414	305
San Francisco	20	11.1	456	5	2.8	360	61,976	25	13.9	436	180
San Jose	30	8.1	409	11	3.0	384	45,274	41	11.1	402	370
Stockton	30	17.1	396	1	0.6	133	2,602	31	17.7	388	175
Redding	30	24.4	386	3	2.4	301	21,554	33	26.8	378	123
Santa Rosa	12	8.8	393	10	7.3	490	61,136	22	16.1	437	137
<b>Totals</b>	<b>247</b>	<b>12.7%</b>	<b>395</b>	<b>63</b>	<b>3.2%</b>	<b>376</b>	<b>\$386,935</b>	<b>310</b>	<b>15.9%</b>	<b>391</b>	<b>1,950</b>

Source: Industrial Relations' Sacramento regional office.

Notes: Our testing indicates that Industrial Relations received full or partial payment on 20 percent of the cases the board completed (63/310). As of June 30, 2003, the Franchise Tax Board had completed only 310 of the 1,950 claims that nine of the Department of Industrial Relations' northern California field offices submitted during fiscal years 2001–02 and 2002–03.

\* Not all payments received were the result of board action. The claims in these columns may also include partial payments, payment plans, and settlement plans that either Industrial Relations or the wage earner negotiated after Industrial Relations forwarded the claims to the board.

† The percentage of claims completed is calculated by dividing the number of claims completed by the total number of claims referred for each field office.

**TABLE 2**

**Thirteen Claims Have Been With the Franchise Tax Board for More Than Two Years With No Resolution**

Steps in the Processing of Claims*	Number of Claims				
	0 to 6 Months	7 to 12 Months	13 to 18 Months	19 to 24 Months	Greater Than 24 Months
From referral to the Franchise Tax Board (board) and input into the Non-Tax Debt Consolidated Debt Collections (CDC) system for processing or until February 29, 2004	12	45	1	0	0
From input into the CDC system and generation of the demand-for-payment notice or until February 29, 2004	43	13	0	0	0
From the demand-for-payment notice and the order to withhold or until February 29, 2004	19	8	5	9	0
Total number of claims that have been with the board to time specified or until February 29, 2004	1	13	18	15	13

Note: Not all rows equal our sample size of 60 because the board has not processed all of the claims through all stages.

\* If this step of the process was not completed, we calculated the number of months using a February 29, 2004, ending date.

By February 29, 2004, the board had completed processing only nine of the 60 claims, three of which generated collections. Although the board took between 315 and 458 days to process them, as shown in the Appendix, these three claims spent the majority of time as part of the backlog of idle claims. The board did not log these claims into the CDC system until 243 to 332 days after Industrial Relations referred them. In fact, for the entire sample of 60 claims, one of the most significant delays occurred between the dates Industrial Relations referred the claims to the board and the dates the board entered them into the CDC system. The Appendix shows that this step of the process took an average of 227 days and that the board did not enter one claim until 406 days, or more than 13 months, after receiving it.

Another significant delay occurred after the board issued the demand-for-payment notice to the employer. Although the board's policy is to generate an order to withhold within 30 days after issuing the demand-for-payment notice, the board does not always follow its policy. As shown in the Appendix, the board took an average of 277 days to generate an order to withhold. Although the board took as few as 26 days to issue an order to withhold, it has yet to issue one for another claim for which it sent a demand-for-payment notice 697 days prior to February 29, 2004.

According to the board's program manager, before issuing an order to withhold, her staff must engage in several time-consuming manual searches. The senior compliance representative who processes the claims must first locate a valid identification number, either a Social Security number if the employer is an individual or a federal employer identification number if the employer is a business. If Industrial Relations does not provide this information, board staff locate the number by searching several state databases, including those of the Department of Motor Vehicles (Motor Vehicles), the Employment Development Department, and the Office of the Secretary of State. According to the program manager, the senior compliance representative then uses this number to search for banks located in the area surrounding the employer's place of business and to send them an order to withhold. If this search fails, the board returns the claim to Industrial Relations.

According to the board's program manager, the process for collecting claims could be expedited if Industrial Relations provided full and accurate identifying information such as a Social Security number, a federal employer identification number, a driver's license number, and any known bank information for the employer's business. We believe that Industrial Relations has the best opportunity to obtain this information when mediating a wage claim between the wage earner and employer. Because Industrial Relations has direct contact with employers during the initial stages of mediation, it can more easily collect this information at that time and pass it on to the board to speed up the collection process.

### **Industrial Relations Does Not Monitor Claims It Has Sent to the Board**

Although Industrial Relations retains the responsibility for managing the SB 1490 Program and the related claims at all times, its assistant chief labor commissioner told us that Industrial Relations does not monitor these claims' status after sending them to the board and even closes the claims in its database. It would seem appropriate and useful for Industrial Relations to require the board to provide some type of status report on individual claims during the time the board is processing them. With this type of information, Industrial Relations could monitor the amount of time the board takes to process claims and could discuss its concerns with the board when the delays seem excessive. Currently, however, Industrial Relations does not monitor these claims' status. It provides the

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*It would seem appropriate that Industrial Relations monitor the length of time it takes the board to process claims and discuss its concerns with the board when delays seem excessive.*

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board with funds to pay for the salary and other administrative costs of only the one employee assigned to process the claims for the SB 1490 Program. Additionally, as we discuss later in this report, Industrial Relations was unable to provide the board with funding to fully automate the system that processes these claims, which the board believed would allow claims to flow through the system in a more expedient manner, thus allowing for better management of the workload and possibly an increase in collections.

### **THE BOARD USES AUTOMATED SYSTEMS FOR TWO OTHER COLLECTION PROGRAMS**

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*Processing is timelier with automated systems because they automatically perform searches of databases for assets and generate letters at specified times, whereas, the SB 1490 Program staff perform these functions manually.*

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According to the board's program manager, using funds provided by the board's general fund and Motor Vehicles, the board had transferred its Child Support Collections and the Vehicle Registration Collections Dishonored Checks programs from the CDC system that the SB 1490 Program currently uses to automated systems by the end of December 2002. The board incorporated the Vehicle Registration Collections Dishonored Checks Program into the existing Vehicle Registration Collections Program. The information related to these two programs is loaded into their systems electronically rather than manually, as the CDC system requires. Additionally, the automated systems for these two programs search various databases for assets, whereas the SB 1490 Program staff perform manual searches. Processing is more prompt with the automated systems because they automatically generate letters at specified times. However, for the SB 1490 Program, staff are required to manually monitor and initiate the process of sending each letter.

During fiscal year 2002–03, the automated system for the Child Support Collections Program processed 854,000 actions that resulted in more than \$78 million in actual collections. These actions include computer-generated activities such as sending notices, levying bank accounts, and garnishing wages. According to the board's collection manager, staff for the Child Support Collections Program perform some manual activities if the automated activities are not successful. The manual activities involve more intensive staff intervention, such as locating the debtor, identifying valuable assets, and seeking to arrange payments. The collection manager, who oversees 42 collectors, indicated that staff within the unit process about 150 to 200 cases each month and that each collector processes seven to eight cases each day.

According to the administrator of the Vehicle Registration Collections Program, its process is highly automated. In 1993 the Legislature transferred the responsibility for collecting delinquent vehicle registration fees to the board. Similar to Industrial Relations, Motor Vehicles does not have the administrative authority to take involuntary administrative collection actions, such as wage garnishments and bank levies. After the 1993 agreement, Motor Vehicles generally refers a case to the board once a vehicle owner is delinquent for 90 days.

The administrator told us that the board receives delinquent vehicle registration information from Motor Vehicles in an electronic format weekly. This information is loaded onto the board's custom database system, which automatically generates a demand-for-payment notice based on contact information from Motor Vehicles. If the debtor has not resolved the account at the end of 30 days, the system automatically searches multiple databases maintained by both the board and other state agencies to locate the debtor's Social Security number. Once it has found a Social Security number, the system searches for bank accounts, wage-earning information, or other assets; it then initiates bank, wage, or other types of levies. During fiscal year 2002–03, this highly automated process handled 900,000 cases for Motor Vehicles and collected nearly \$80 million. The manual part of this collection process primarily involves answering telephone calls from debtors who are subject to involuntary collection actions.

### **THE BOARD AND INDUSTRIAL RELATIONS ABANDONED A PROJECT THAT WOULD IMPROVE THEIR COLLECTION PROCESS**

***The board believed that by automating its system, the SB 1490 Program claims would be concluded in a more expedient manner, allowing for better management of the workload and potentially increasing the revenue to Industrial Relations.***

Between 2000 and 2002 the board conducted two studies—a program proposal and a feasibility study—to improve the collection activities of its SB 1490 Program as well as the program that Chapter 33, Statutes of 1995, Senate Bill 996 (SB 996), established. The SB 996 Program authorizes Industrial Relations to levy assessments and penalties on employers who have the worst safety records. The board's program manager told us that the program proposal sought to decrease backlog and potentially increase revenue collections, whereas the feasibility study presented a detailed analysis of program weaknesses and the benefit of automating the clerical tasks associated with the current manual CDC system. The board believed that by fully automating the system, it could complete claims in a more expedient manner, allowing for better management of the workload and a potential



increase of revenue to Industrial Relations. The board also believed these revenues would increase the level of benefits and services to California workers as well as lessen the burden on expenditures to the State's General Fund. However, after realizing that it would not receive additional funding to implement these changes, the board abandoned the idea of automating its collection activities for these two programs.

### **The Board Developed a Program Proposal to Improve Its Collection Process**

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*According to the proposal, with the appropriate system changes, it could generate up to \$6.6 million in annual collections by fiscal year 2004–05, a 676 percent increase from the collections generated under the current system.*

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According to the board's program manager, in 2000 the board began planning efforts to automate its SB 1490 and SB 996 claims and prepared a proposal to identify ways to decrease the backlog and increase revenue collections. The proposal suggested automating the clerical aspects of the current CDC system and adding four new staff positions. According to the proposal, with the appropriate system changes eliminating manual clerical tasks and with the addition of four staff, the board could generate up to \$6.6 million in annual collections by fiscal year 2004–05, or a 676 percent increase from the collections that the current system generates. The board estimated that increasing the number of staff by three compliance representatives and one tax technician would increase program costs from the current amount of the two contracts totaling \$175,000 to \$400,000. The proposal estimated that automation costs for both Industrial Relations and the board would be about \$1.5 million, bringing the total cost of the project to \$1.9 million.

According to the program manager, the board met with Industrial Relations in March 2002 to discuss improvements to the system that processes the SB 1490 and SB 996 claims. During this meeting, Industrial Relations expressed a sincere desire to continue its partnership with the board and committed to providing the board with additional funding both to expand its collection staff and fund a new automated collection system. However, according to the board's program manager, the Industrial Relations division chief overseeing the SB 996 Program committed to providing the board with additional funding to expand its collection staff and to fund a new automated collection system. However, while desiring to continue the relationship with the board, the Industrial Relations' division chief of the SB 1490 Program declined at that time to provide any additional funding for the project. The program manager indicated that the board therefore continued to gather information on the feasibility of automating its manual collection system.

## **The Board Developed a Plan to Automate the Collections Process for Its SB 1490 and SB 996 Claims**

In May 2002 the board prepared a feasibility study that addressed the need to automate its current CDC system. The feasibility study highlighted the weaknesses in the collection process for the Industrial Relations claims. It also highlighted the benefits that the board and Industrial Relations could generate if they collaborated to automate the CDC system.

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*The board's feasibility study found that the lack of automation forces most of the board's workload efforts to focus on manual collection activities.*

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The feasibility study found that the lack of automation forces most of the board's workload effort to focus on manual collection activities. Staff spent time on manual collection activities, which kept them from completing traditional collection actions such as making phone calls, searching for additional assets, and providing customer service. Additionally, the feasibility study pointed out that data for Industrial Relations claims are stored in multiple software programs, forcing staff to use multiple applications to process data and generate notices, contributing to further delays in processing claims.

The board's feasibility study also indicated that only the SB 1490 and SB 996 Programs are still using the CDC system, which the board developed in 1993 exclusively to collect delinquent child support. Since 1993 the board added other collection programs to the CDC system, such as court-ordered debt collections, its Vehicle Registration Collections Dishonored Checks Program, and Industrial Relations claims that SB 1490 and SB 996 generated. However, by the end of December 2002, the board had automated all but the SB 1490 and SB 996 programs.

According to the feasibility study, the CDC system faces several challenges. For example, the software used to develop the CDC system is now outdated, and the vendor no longer supports it. Furthermore, finding and retaining qualified staff knowledgeable in this technology is becoming more difficult. The feasibility study points out that if the board does not implement a new system, when the CDC system is no longer operational, the board will be unable to meet the business requirements and legal mandates to administer the SB 1490 and SB 996 programs.

Additionally, according to the feasibility study, the information between the board and Industrial Relations is slow, cumbersome, and inefficient. The board has not modified the existing method of data exchange—paper documents and a 3.5-inch diskette—since it implemented the two programs in 1994. Transmitting information electronically, according to the feasibility study, would be more efficient for both the board and Industrial Relations and

less costly. The feasibility study estimated that the board could increase its annual collections for both programs to \$7.1 million by fiscal year 2005–06 with an automated system.

The board abandoned the project in May 2002 when it realized it would not obtain the necessary funds to pay for the project. According to the assistant chief labor commissioner, although Industrial Relations could not provide the funds needed to automate, Industrial Relations believes that the board overall does a fairly good job and that Industrial Relations would most likely not have collected any of the referred claims without the board’s efforts.

**OTHER STATES USE AUTOMATED PROCESSES, AND ONE CHARGES A FEE FOR ITS SERVICES**

We reviewed three state collection programs similar to the SB 1490 Program; all three states currently have or are working on implementing some level of system automation for collecting their claims. One of the three states retains a percentage of the amount collected on wage earners’ behalf to cover its own collection costs and the costs of sending the claims to a collection agency. Industrial Relations and the board might consider the benefit of charging a similar fee to improve the SB 1490 Program.

We compared California’s collections of claims to those of Oregon, Texas, and Washington. Table 3 presents the differences in the collection processes among the states.

**TABLE 3**

**Unlike California, Other States Have Automated Systems for Collecting Their Delinquent Labor Claims**

	Transfers Claims to Another State Agency	Uses a Private Collection Agency	Has Automated Processes for Collecting Delinquent Claims
California	Yes	No	No
Oregon	Yes	Yes	Yes
Texas	No	No	Yes
Washington	Yes*	No	Yes†

\* Although Washington’s Department of Labor and Industries can transfer claims to the attorney general, it prefers not to avail itself of this option. In fact, during 2001 and 2002, the Department of Labor and Industries transferred to the attorney general a total of three labor claims.

† Washington’s system is only partially automated. The system can generate some correspondence between the Department of Labor and Industries and employers. However, staff still need to manually locate assets as part of their investigative process.

Staff from Washington’s Department of Labor and Industries (labor department) told us that the upgrade of its automated wage claim system is scheduled for completion sometime this summer. Additionally, the labor department recently increased its claims staff to a total of five employees.

According to staff with the Texas Workforce Commission Labor Law Section (commission), the commission administers the Texas Payday Law, which assists wage earners with the collection of unpaid wages. The commission’s collection processes are automated, and nine employees—eight collectors and one supervisor—are assigned to its wage collection program.

An official with Oregon’s Bureau of Labor and Industries told us that Oregon has a highly automated collection process that electronically transfers claims to its Department of Revenue, which has up to one year to attempt collection. If the Department of Revenue collects the claim, it retains 12 percent of the payment. If it fails to collect on a claim after one year, it returns the claim to the Bureau of Labor and Industries, which then sends the claim to a private collection agency. The private collection agency retains 20 percent of the amount due to the wage earner if it successfully obtains payment on a claim. According to this official, although the percentage that the collection agency retains appears high, the original collection amount grows over time as penalties and interests are added to the wage earner’s claim.

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***Industrial Relations should consider charging employers a fee that the board and Industrial Relations could use to automate the collection process and pay for additional staff.***

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Industrial Relations should consider charging employers some percentage or a set fee for their efforts to collect both SB 1490 and SB 996 claims that they could use to automate the collection process and pay for additional staff. In fact, SB 1490 requires Industrial Relations to adopt rules and regulations to charge the employer a reasonable fee to cover the board’s collection costs, a fee that Industrial Relations does not currently charge. We believe that pursuing this option would clearly benefit California’s wage earners, as well as the State. If Industrial Relations believes this to be a feasible option, it would need to perform an analysis to determine the appropriate fee to charge and develop appropriate rules and regulations.

## RECOMMENDATIONS

To ensure that the board has the information it needs to process each claim as promptly as possible, Industrial Relations should attempt to obtain more complete identifying information from the employer during its mediation process and provide this information to the board when referring any claims for collection. This information should include the employer's Social Security number or federal employer identification number, driver's license number, and any known bank information related to the employer's business.

To monitor the amount of time the board takes to process claims and discuss any concerns when the delays seem excessive, Industrial Relations should require the board to periodically provide it with a status report on individual claims.

If the administration is unwilling to provide the additional resources needed to ensure that the board processes claims from Industrial Relations more promptly, Industrial Relations should consider taking the following actions:

- Adopt rules and regulations to charge a fee, as state law requires, to employers that delay paying their claims; the board and Industrial Relations could use such funds to automate the current system and increase staffing levels as needed.
- Prepare a cost analysis to determine the appropriate fee to charge employers that delay paying their claims.

If the board and Industrial Relations automate the current system and increase staffing levels, Industrial Relations should periodically resubmit unpaid claims for processing.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



ELAINE M. HOWLE  
State Auditor

Date: May 13, 2004

Staff: Denise L. Vose, CPA, Audit Principal  
Dawn S. Tomita  
Claudia Orsi  
Sang Park

# APPENDIX

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## ***Significant Delays Occurred at Two Points in the Board's Process for Collecting Claims***

Table A.1 on the following page illustrates, for a sample of 60 claims the Department of Industrial Relations sent to the board during fiscal years 2001-02 and 2002-03, the length of the delays that occurred at certain points in the Franchise Tax Board's (board) process for collecting claims. The most significant delays occurred at two points in the process. The first occurred after the board received the delinquent claim. Specifically, the board took an average of 227 days to enter claims into its Non-Tax Debt Consolidated Debt Collections system for processing. The second significant delay occurred between the dates that the board sent the demand-for-payment notice and the order to withhold. The board took an average of 277 days to issue the letter. Finally, the table also shows that these 60 claims have been with the board for an average of 538 days.

**TABLE A.1**

**Significant Delays Occurred at Two Points in the Board's Process for Collecting Claims**

Number	Referring Field Office	Days Between Referral to the Franchise Tax Board (Board) and Input Into the Non-Tax Debt Consolidated Debt Collections (CDC) System*	Days Between Input Into the CDC System and Generation of Demand-for-Payment Notice*	Days Between Demand-for-Payment Notice and Claim Return Date	Days Between Demand-for-Payment Notice and Order to Withhold*	Days Between the Order to Withhold and the Date the Claim Was Returned to the Department of Industrial Relations*	Total Number of Days the Claim Was at the Board*	Status of Claim
1	Van Nuys	207	19	21	48	89	117	The claim was returned on February 10, 2003, because the plaintiff plans to pursue collection on his own.
2	Long Beach	143	0	21	48	89	247	The claim was returned on September 17, 2002, because the board was unable to collect because the defendant was bankrupt.
3	Oakland	292	0				280	Claim is still active at the board.
4	Stockton	103	191				292	Claim is still active at the board.
5	Los Angeles	117	184				294	Claim is still active at the board.
6	Los Angeles	121	77				301	Claim is still active at the board.
7	Fresno	243	45	27	62	46	306	Claim is still active at the board.
8	Santa Ana	118	0				315	Claim was paid in full on February 5, 2003. The payment was issued to the employee on February 25, 2003.
9	Van Nuys	150	187				324	The claim was returned on October 31, 2002, because the board was unable to locate assets.
10	San Bernardino	283	6	51	26		328	Claim is still active at the board.
11	Sacramento	156	188				337	Claim is still active at the board.
12	Sacramento	162	188				340	The claim was returned on August 29, 2002, because the board was unable to locate assets.
13	Sacramento	156	188				344	Claim is still active at the board.
14	Sacramento	162	188				350	Claim is still active at the board.



Number	Referring Office	Days Between Referral to the Franchise Tax Board (Board) and Input Into the Non-Tax Debt Consolidated Debt Collections (CDC) System*	Days Between Input Into the CDC System and Generation of Demand-for-Payment Notice*	Days Between Demand-for-Payment Notice and Claim Return Date	Days Between Demand-for-Payment Notice and Order to Withhold*	Days Between the Order to Withhold and the Date the Claim Was Returned to the Department of Industrial Relations*	Total Number of Days the Claim Was at the Board*	Status of Claim
15	San Bernardino	15	2		84	305	406	Claim is still active at the board.
16	San Bernardino	212	82		51	67	412	The claim was returned on March 17, 2003, because the board was unable to collect since the defendant was bankrupt.
17	Long Beach	221	192				413	Claim is still active at the board.
18	Long Beach	187	78		75	75	415	The claim was returned on November 17, 2003, because the board was unable to locate assets.
19	Santa Ana	325	20	76			421	The claim was returned on June 17, 2003, because the board was unable to collect since the defendant was bankrupt.
20	Sacramento	119	168		138		425	Claim is still active at the board.
21	San Bernardino	241	193				434	Claim is still active at the board.
22	San Bernardino	242	193				435	Claim is still active at the board.
23	San Francisco	406	33				439	Claim is still active at the board.
24	Van Nuys	275	55		50	61	441	The claim was returned on August 26, 2003, because the claim was paid in full by a bank levy.
25	San Diego	254	193				447	Claim is still active at the board.
26	Santa Rosa	332			48	78	458	A partial payment was received on December 5, 2003, and payment issued on January 8, 2004. The claim is still at the board.
27	San Bernardino	282	194				476	Claim is still active at the board.
28	Stockton	297	192				489	Claim is still active at the board.
29	Sacramento	191	168		138		497	Claim is still active at the board.
30	San Diego	194	214		52	45	505	Claim is still active at the board.
31	Fresno	199	80		254		533	Claim is still active at the board.
32	San Jose	234	209		54	47	544	Claim is still active at the board.

continued on the next page

Number	Referring Field Office	Days Between Referral to the Franchise Tax Board (Board) and Input Into the Non-Tax Debt Consolidated Debt Collections (CDC) System*	Days Between Input Into the CDC System and Generation of Demand-for-Payment Notice*	Days Between Demand-for-Payment Notice and Claim Return Date	Days Between Demand-for-Payment Notice and Order to Withhold*	Days Between the Order to Withhold and the Date the Claim Was Returned to the Department of Industrial Relations*	Total Number of Days the Claim Was at the Board*	Status of Claim
33	San Diego	295	161	97	553	553	Claim is still active at the board.	
34	Van Nuys	225	129	199	553	553	Claim is still active at the board.	
35	Van Nuys	225	129	47	152	553	Claim is still active at the board.	
36	Santa Ana	259	81	61	172	573	Claim is still active at the board.	
37	San Diego	325	164	50	47	586	Claim is still active at the board.	
38	Long Beach	277	48	181	103	609	Claim is still active at the board.	
39	Long Beach	286	44	181	103	614	Claim is still active at the board.	
40	Los Angeles	289	44	284	617	617	Claim is still active at the board.	
41	San Jose				629	629	The board is unable to locate this claim.	
42	Fresno	293	51	215	103	662	Claim is still active at the board.	
43	Fresno	293	51	318	662	662	Claim is still active at the board.	
44	Fresno	278	12	376	666	666	Claim is still active at the board.	
45	San Diego	295	37	322	678	678	Claim is still active at the board.	
46	San Jose	0	14	683	697	697	Claim is still active at the board.	
47	San Bernardino	279	24	191	221	715	Claim is still active at the board.	
48	Fresno	184	36	523	743	743	Claim is still active at the board.	
49	Fresno	184	36	523	743	743	Claim is still active at the board.	
50	Santa Ana	71	16	675	762	762	Claim is still active at the board.	
51	San Diego	203	34	537	774	774	Claim is still active at the board.	
52	Santa Ana	250	56	198	270	774	Claim is still active at the board.	
53	Long Beach	207	19	551	777	777	Claim is still active at the board.	
54	Fresno	241	26	551	818	818	Claim is still active at the board.	
55	Los Angeles	253	15	551	819	819	Claim is still active at the board.	
56	Sacramento	258	36	537	831	831	Claim is still active at the board.	
57	Los Angeles	274	15	551	840	840	Claim is still active at the board.	

Number	Referring Office	Days Between Referral to the Franchise Tax Board (Board) and Input Into the Non-Tax Debt Consolidated Debt Collections (CDC) System*	Days Between Input Into the CDC System and Generation of Demand-for-Payment Notice*	Days Between Demand-for-Payment Notice and Claim Return Date	Days Between Demand-for-Payment Notice and Order to Withhold*	Days Between the Order to Withhold and the Date the Claim Was Returned to the Department of Industrial Relations*	Total Number of Days the Claim Was at the Board*	Status of Claim
58	San Bernardino	270	22	570	862	Claim is still active at the board.		
59	San Bernardino	292	28	570	890	Claim is still active at the board.		
60	Santa Rosa	238	8	697	943	Claim is still active at the board.		
<b>Total number of days</b>		<b>13,167</b>	<b>4,687</b>	<b>175</b>	<b>11,350</b>	<b>2,183</b>	<b>32,308</b>	
<b>Average number of days</b>		<b>227</b>	<b>84</b>	<b>44</b>	<b>277</b>	<b>115</b>	<b>538</b>	

\* If this step of the process was not completed, we calculated the number of days using a February 29, 2004, ending date.

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*Agency's comments provided as text only.*

State and Consumer Services Agency  
915 Capitol Mall, Suite 200  
Sacramento, CA 95814

April 29, 2004

Elaine M. Howle  
Bureau of State Audits  
555 Capitol Mall, Suite 300  
Sacramento, CA 95814

Dear Ms. Howle:

Enclosed is our response prepared by the Franchise Tax Board to the Bureau of State Audits' Report No. 2003-131 entitled, *Franchise Tax Board: Significant Program Changes Are Needed to Improve Collections of Delinquent Labor Claims*. A copy of the response is also included on the enclosed diskette.

If you have any questions or need additional information, please contact me at (916) 653-4090.

Sincerely,

*(Signed by: George Valverde for)*

Fred Aguiar, Secretary  
State and Consumer Services Agency

Enclosures

Franchise Tax Board  
PO Box 115  
Sacramento, CA 95741-0115

**MEMORANDUM**

To: Fred Aguiar, Secretary  
State and Consumer Services Agency  
915 Capitol Mall, Suite 200  
Sacramento, CA 95814

From: Gerald H. Goldberg

Subject: Audit Report - Franchise Tax Board: Significant Program Changes Are Needed to Improve Collections of Delinquent Labor Claims

Attached is our response to the State Auditor's Draft Audit Report - Franchise Tax Board: Significant Program Changes Are Needed to Improve Collections of Delinquent Labor Claims. Per the State Auditor's request, the response is also included on the enclosed diskette.

If you need any further information or would like to discuss any of the issues above, please feel free to contact Philip Yu at 845-3388.

*(Signed by: Gerald H. Goldberg)*

Executive Officer

Attachment

Franchise Tax Board  
PO Box 115  
Sacramento, CA 95741-0115

MEMORANDUM

To: Elaine M. Howle, State Auditor April 29, 2004  
Bureau of State Audits  
555 Capitol Mall, Suite 300  
Sacramento, CA 95814

From: Gerald H. Goldberg

Subject: Audit Report - Franchise Tax Board: Significant Program Changes Are Needed to Improve Collections of Delinquent Labor Claims

Thank you for the opportunity to review the draft audit report prepared by your staff for the Joint Legislative Audit Committee.

We appreciate your recommendations for improving our method of processing delinquent labor claims for the Department of Industrial Relations. We concur that improvements can be made. As noted in your audit, on our own initiative we have conducted studies and continually evaluated the need for improving our ability to respond to the growing level of SB1490 cases placed with us. In addition, we have studied the need to improve program efficiencies by automating this workload. Our conclusion is that additional monies are needed to accomplish this.

Over the past three fiscal years, we have had on-going discussions to address opportunities to enhance revenue, by increasing staff and automating the Industrial Relations workload. As a result of those discussions we received a small increase in monies for the SB996 workload, but we received no additional funding for SB1490. Over that same time period, the SB1490 workload has grown from an average of 4700 cases per year to over 5700 cases per year, including cases currently waiting collection actions; thus, creating a case backlog.

Despite collections of over \$3.1M for SB1490 over the last three fiscal years, several changes to the program will allow us to address the backlog, maximize collections, and improve program efficiencies.

Following are specific comments to the report and the recommendations:

**BSA Statement (Page 7 & 8):**

*In response to this law, the board entered into a second contract with industrial Relations, which for fiscal year 2003 – 04 was for \$55,000.*

**FTB Response:**

The contract amount for the SB996 workload for fiscal year 2003-2004 is \$75,000.<sup>1</sup>

**BSA Statement (Page 9):**

*For those employers it is able to locate, the board mails a demand-for payment notice with an order to remit payment to Industrial Relations.*

**FTB Response:**

The board mails a demand for payment notice on all accounts received from Industrial Relations.<sup>1</sup>

**BSA Recommendation (Page 14 & 15):**

*We believe, however, this suggests that the board could be more successful in generating collections not only by processing claims more promptly but also by allowing Industrial Relations to periodically resubmit unpaid claims for processing more than one time, which currently it does not do.*

**FTB Response:**

Industrial Relations may submit a case as often as it deems necessary. FTB does not limit the number of times that a case may be submitted.<sup>1</sup>

**BSA Recommendation (Page 18):**

*It would seem appropriate and useful for Industrial Relations to require the board to provide some type of status report on individual claims during the time the board is processing them.*

**FTB Response:**

FTB can provide Industrial Relations with a status report on individual claims placed with the board for collections but producing these reports requires the program to have some level of automation. With adequate funding to develop the proper automation, FTB can provide this service.

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<sup>1</sup> Text modified in final report.



**BSA Analysis:**

**THE BOARD USES AUTOMATED SYSTEMS FOR TWO OTHER COLLECTION PROGRAMS**

FTB agrees with the analysis regarding the use of automated systems for two other collection programs, i.e. child support and vehicle registration collections. However, it is important to note that the type of debt and the size of both programs, i.e. staffing, case loads, and access to information (as outlined by statute) are significantly different than the delinquent Industrial Relations wages claims (SB1490) placed with the board. In addition, both child support and vehicle registration collections received funding to build automated collection systems.

**BSA Statement (Page 24):**

*The board has not modified the existing method of data exchange – paper documents and a 3.5-inch diskette – since it implemented the two program in 1994.*

**FTB Response**

Modification of the data exchange process can only be done if the client has the capability of utilizing the new methods of data exchange. In numerous discussions, FTB has been informed that (SB1490) is unable to automate beyond its current capacity, which is a paper format.

**FTB Additional Recommendations:**

To address the backlog cases, additional funding for permanent staffing is strongly recommended. However, funding for temporary help could provide some relief in performing many needed program activities.

SB996 currently resides on the Consolidated Debt Collection System. As noted this system is dated and no longer supported by the vendor. Continued reliance on this system puts the program at risk. SB1490 is tremendously disadvantaged due to its lack of automation. An individual must perform manual activities that could be performed through automated processes. This is time consuming, labor intensive, and clearly does not maximize FTB's administrative authority.

FTB is again able to conduct a study to analyze the feasibility of automating both SB996 and SB1490 workloads at the beginning of fiscal year 04/05. Additional funding is needed for this study; otherwise, program dollars allocated for Industrial Relations collections must be used. Once the analysis is complete, monies will be needed to build an automated collection system. Failing to provide additional monies limits FTB's ability to process cases, respond to debtors, and collect revenue in a timely manner. In addition, a lack of automation ultimately impacts the amount of monies, which goes back into the State's General Fund.

Again, we appreciate the opportunity to provide you with this response. If you need any further information or would like to discuss any of the issues above, please feel free to contact Philip Yu at 845-3388.

*(Signed by: Gerald H. Goldberg)*

Executive Officer

*Agency's comments provided as text only.*

California Labor and Workforce Development Agency  
801 K Street, Suite 2101  
Sacramento, CA 95814

April 29, 2004

Elaine M. Howle\*  
555 Capitol Mall  
Sacramento, CA 95814

Dear Ms. Howle:

This is in response to the Bureau of State Audits (BSA) draft report entitled "Franchise Tax Board: Significant Program Changes Are Needed to Improve Collections of Delinquent Labor Claims" which was delivered to the Labor and Workforce Development Agency (LWDA) on April 23, 2004.

On page 18 the report indicates that "the process for collecting claims could be expedited if Industrial Relations provided full and accurate identifying information such as a social security number, a federal employer identification number, driver's license number, and any known bank information for the employer's business. We believe that Industrial Relations has the best opportunity to obtain this information when mediating a wage claim between the wage earner and employer."

The Department agrees but must clarify that whenever possible the Department staff does attempt to obtain this information. We do not, however, have the authority to require that employers provide the information. The Department attempts to obtain this information directly from the employer and through the individual workers who file claims in our offices. In addition, when DIR staff conducts inspections of employer- businesses that result in penalties being assessed, it attempts to obtain this information since we recognize that the information can lead to collection of the amounts assessed. Whenever the information is obtained, it is provided to the FTB.

On page 18, the report also states that "Although Industrial Relations retains the responsibility for managing the SB 1490 Program and the related claims at all times, according to its assistant chief labor commissioner, Industrial Relations does not monitor the status of these claims after they are sent to the board and even closes them in its database."

The Department does not agree that it retains responsibility for managing the SB 1490 Program after debts are transferred to the FTB. The statute transfers the responsibility from the department to the Franchise Tax Board for the collection of delinquent fees, wages, penalties and costs, and any interest thereon. (See Revenue and Taxation Code Section 19290 (a)) The DIR has no authority over the FTB or its processes. The DIR believes that every dollar collected by the FTB is money that would likely not have been collected otherwise. The employer-debts transferred to the FTB are debts where voluntary compliance efforts failed.

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\* California State Auditor's comment appears on page 41.

On page 22, the report states “the board met with Industrial Relations in March 2002 to discuss improvements to the system that processes the SB 1490 and SB 996 claims. During this meeting, Industrial Relations expressed a sincere desire to continue its partnership with the board and committed to providing the board with additional funding to expand its collection staff and to fund a new automated collection system.”

The Department agrees that discussions have taken place with the FTB over the nearly ten years the program has operated. We have discussed additional funding but as a General Fund Division, the Department has not been in a position to provide additional funding to the FTB. We have periodically offered other solutions to the automation of the program including DIR staff directly entering information into any database provided by the FTB, providing the debt information in a computerized format furnished by the FTB or emailing information to the FTB. The FTB, however, has insisted that a copy of the judgment entered by the DIR accompany its referrals making these options impossible.

The DIR will continue to work with the FTB to determine if there are other alternatives for improving the program including reviewing whether rules and regulations allowing the FTB to assess fees to employers to cover their collection costs should be adopted. In addition, because of our concern over collection efforts, the Labor and Workforce Development Agency is currently looking at other potential options to improve collection of fines and penalties to better enforce the labor laws of California.

Thank you for the opportunity to review and respond to your report on the FTB’s collection efforts on behalf of the DIR. If you have any questions regarding this response, please contact Marisa Duek, Associate Secretary of Fiscal Policy and Administration or myself at (916) 327-9064.

Sincerely,

*(Signed by: Victoria L. Bradshaw)*

Victoria L. Bradshaw  
Acting Secretary

# COMMENT

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## ***California State Auditor's Comment on the Response From the Department of Industrial Relations***

To provide clarity and perspective, we are commenting on the Department of Industrial Relations' (Industrial Relations) response to our audit report. The following number corresponds to the number we have placed in Industrial Relations' response.

- Apparently there is some confusion on the part of Industrial Relations as to who is ultimately responsible for managing the claims Industrial Relations refers to the Franchise Tax Board (board) for collection as required by Senate Bill 1490. The board's Industrial Health and Safety Collections Program Procedure Manual for its SB 1490 Program states it is important to note that throughout the collection process, Industrial Relations retains management responsibility for all cases it refers to the board. Conversely, as Industrial Relations states in its response, it believes that it does not retain responsibility for managing the SB 1490 Program claims after Industrial Relations refers them to the board.