

FRANCHISE TAX BOARD

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.*

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

REPORT NUMBER 2003-131, MAY 2004

Responses of the Franchise Tax Board and the Department of Industrial Relations as of May 2005

The Joint Legislative Audit Committee requested that the Bureau of State Audits review the Franchise Tax Board's (board) collection activities in connection with delinquent fees, wages, penalties, costs, and interest (claims) that the Department of Industrial Relations (Industrial Relations) referred to it. 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.

Finding #1: The board's success rate in collecting money on Industrial Relations claims is limited.

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. 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.

Our review of the amount of time involved between the individual steps of the claim collections process found that a 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. We found that the board took an average of 277 days to generate an order to withhold.

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, 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.

We recommended that to ensure 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.

Industrial Relations' Action: None.

➡ As Industrial Relations stated in its original response to our audit report, its staff attempts to obtain information from both the employer and the worker during its mediation process. However, although it requests that the employer provide either a federal or state employer identification number, Industrial Relations believes it does not have the authority to mandate that employers provide this information.

Finding #2: Industrial Relations does not monitor claims it has sent to the board.

Even though the board is authorized to collect delinquent fees, wages, penalties, costs, and interest (claims), Industrial Relations retains the responsibility for managing the claims at all times. The assistant chief labor commissioner told us, however, 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 board with funds to pay for the salary and other administrative costs of only the one employee assigned to process these claims. Additionally, 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.

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

Board's Action: Corrective action taken.

The board stated that it provided Industrial Relations a report on the backlog of cases in April 2005 covering inventory from July 2004 through April 2005. According to the board, this report showed significant improvements.

Industrial Relations' Action: Corrective action taken.

Industrial Relations stated that it meets quarterly with the board's staff to discuss any issues that may arise, including the board's progress on reducing its backlog of cases. In addition, when requested, the board provides Industrial Relations with status reports on cases referred to it. According to Industrial Relations, the board has shown remarkable improvement in the processing of cases and reducing the backlog.

Finding #3: The board and Industrial Relations abandoned a project that would improve their collection process.

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 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 similar collection programs 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 authorizing the board's collection activities and would clearly benefit California's wage earners, as well as the State.

We recommended that 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.

Further, we recommended that if the board and Industrial Relations automate the current system and increase staffing levels, Industrial Relations should periodically resubmit unpaid claims for processing.

Board's Action: Partial corrective action taken.

The board stated that Industrial Relations increased the amount of funds allocated to the program for the fiscal year 2004–05 contract and loaned the board a part-time employee, effective January 2005. The board also indicated that it hired two temporary employees and is currently working with Industrial Relations to address staffing needs for fiscal year 2005–06. Finally, the board plans to continue to work with Industrial Relations to explore various methodologies to assist Industrial Relations in adding collection fees to accounts placed with the board.

Industrial Relations' Action: Partial corrective action taken.

Industrial Relations stated that it is currently upgrading its computer system. One component of the upgrade is to determine how to electronically transfer information to the board. To discuss this further, Industrial Relations has scheduled a meeting with the board to determine how best to accomplish this transfer. Industrial Relations also indicated that it continues to discuss the possibility of adopting regulations that would allow the board to collect fees from debtors. However, Industrial Relations believes there is a concern that the board would not collect enough fees and Industrial Relations would still be required to fund the board's collection efforts.