



STATE OF WASHINGTON
OFFICE OF FINANCIAL MANAGEMENT

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November 21, 2014

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

Dear Auditor Kelley:

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

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

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

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

State agencies that participated in the audit currently have strong debt collection practices that include some debt-offset strategies, both in their agencies and among other state, local and federal jurisdictions. Some Washington State agencies already participate in the U.S. Treasury's Offset Program (TOP). TOP reported that Washington State recovered \$51.1 million in fiscal year 2013



by participating in three of the five Treasury offset programs. For examples of additional debt-offset practices, please see Attachment A.

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

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

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

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

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

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

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

Other debt included in the audit analysis is being paid off through agreed-upon payment plans; this debt would also likely not be processed through a comprehensive debt-offset system. It is critical to identify the right types of business debt for the right reasons and ensure they have due process prior

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to an automatic offset. We believe manual checks to ensure the debt still exists would continue to be needed, as well as established policies and processes for appeals.

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

Sincerely,



David Schumacher
Director

cc: Joby Shimomura, Chief of Staff, Office of the Governor
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Lynn Peterson, Secretary, Department of Transportation

ATTACHMENT A – EXAMPLES OF CURRENT DEBT-OFFSET PRACTICES

	In Agency	Other State Agencies or Local Jurisdictions	Federal
Employment Security		<ul style="list-style-type: none"> • Interface with DOR credit system for debit balance on ESD account • Lottery winners – offset winnings against taxes owed (sole proprietors) • Manually issue withholds to offset credits at Labor and Industries • Vehicle or vessel lien interface with Department of Licensing • Manually issue withholds to offset credits at DOR • Public works retainage claims initiated with the Attorney General • Contractor bond packets submitted to the Attorney General, and the courts submit a letter to the surety company 	Treasury Offset Program interface with Federal Management Services Bureau within the IRS to commence in January 2015 (sole proprietors and general partnerships)
Health Care Authority	Medicaid, medical and other selected payments are consolidated in the single provider payment system, ProviderOne, which automatically recoups overpayments by offsetting the debt against current payments due to providers		

Labor and Industries	<ul style="list-style-type: none"> • Offset provider overpayments against future payments to those providers • Offsets to employers for Stay at Work program for amounts owed to the agency, including taxes and unpaid wages owed to WA workers 	<ul style="list-style-type: none"> • Lottery winners – offset winnings against claim overpayments owed (individuals) • Unclaimed property – offset unclaimed property against debt owed • Manually issue withholds to offset credits at DOR and ESD • Public works contracts – file a lien against the retainage bond 	Federally funded transportation projects – levy contract bonds for federally funded transportation projects
Washington’s Lottery		<ul style="list-style-type: none"> • Lottery winners (natural persons) of prizes greater than \$600. Business debt may be withheld when business structure is a sole proprietorship. • No prize payment debt offset for vendor payments 	
Social and Health Services	Offset payments to vendors currently providing services to DSHS	<ul style="list-style-type: none"> • Offset payments to vendors providing services to the Department of Early Learning and Health Care Authority • Offset WA Lottery winnings greater than \$600 	
Revenue	<ul style="list-style-type: none"> • Unclaimed property – offset unclaimed property against debt owed • DOR Credit System – offset debt against credits owed to a taxpayer 	<ul style="list-style-type: none"> • Lottery winners – offset winnings against taxes owed (sole proprietor) • Public works contracts – file a lien against the retainage bond 	Federally funded transportation projects – levy contract bonds for federally funded transportation projects

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

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

SAO PERFORMANCE AUDIT OBJECTIVES:

The SAO sought to answer three questions:

1. Can a state debt-offset program help Washington collect delinquent business debt?
 2. Can participation in the U.S. Treasury's State Reciprocal Program help Washington collect delinquent business debt?
 3. What actions would Washington need to take to develop and implement effective debt-offset programs?
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SAO Issue 1: A state debt-offset program could have helped Washington more quickly recover about \$4 million in delinquent business debt in one month.

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

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

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

STATE RESPONSE:

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

Action Steps and Time Frame

- None applicable. *Directed to the Legislature.*
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SAO Recommendation 2: The Legislature authorize state agencies to participate in the U.S. Treasury's State Reciprocal Program.

STATE RESPONSE:

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

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

Action Steps and Time Frame

- › None applicable. *Directed to the Legislature.*

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

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

STATE RESPONSE:

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

Automated debt-offset between agencies is a complex topic with potential for significant unintended consequences and costs. Assuming the Legislature provides funding to establish a work group, we believe that in addition to the elements the SAO identified, careful consideration must be given to

how an automated cross-agency system may affect businesses. The performance audit did not include input from the business community about potential impacts to Washington's business climate.

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

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

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

Action Steps and Time Frame

- None applicable. *Directed to the Legislature.*
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SAO Recommendation 4: Taking into account the workgroup's June 2016 report, the Legislature authorize a single comprehensive statute to offset debts owed by businesses with payments to those businesses.

STATE RESPONSE:

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

Action Steps and Time Frame

- None applicable. *Directed to the Legislature.*