

# Chapter 3

## Department of Finance

### Consumption Tax

#### Contents

Background . . . . .	33
Scope . . . . .	34
Results in Brief . . . . .	35
Final Audit of Consumption Tax Accounts . . . . .	36
Collection of Consumption Tax Accounts . . . . .	40
Performance Information . . . . .	46
Backlog of Accounts to be Written Off . . . . .	48
Information for Future Action . . . . .	49
General Concluding Comments on Collections . . . . .	50

# Department of Finance

## Consumption Tax

### Background

**3.1** From 1993 to 1997 the provincial Social Services and Education Tax (Consumption Tax) contributed an average of \$680 million per year to provincial tax revenues. This was second only to the federally administered "Taxes on Income" as the major provincial revenue source available to finance government programs. As of 1 April 1997 the Consumption Tax was replaced by the federally administrated Harmonized Sales Tax.

**3.2** Most of the Consumption Tax revenue represented taxes collected by New Brunswick vendors and reported and remitted to the Province. Historically, a small percentage of vendors did not report and/or remit funds owing to the Province. A larger percentage of vendors through errors, misinterpretations and omissions, did not always remit the full amount of tax due. To address the taxes owing by these two groups, the Province had long maintained a tax audit function. The arrival of the HST did not immediately end the need for audit. The Province must continue to have an effective and efficient support system for assessing and collecting sales tax until substantially all revenue owing to the Province for tax transactions prior to 1 April 1997 is assessed and collected. This not only provides funds for government programs, but also prevents vendors who do not remit taxes from having an unfair advantage over vendors that do.

**3.3** Due to the replacement of Consumption Tax we wanted to ensure that the assessment and collection activities were not scaled back before adequately addressing the unassessed taxes and uncollected tax receivable. Our concerns were magnified by a number of significant comments in prior Reports of the Auditor General.

**3.4** In 1992 we conducted a value-for-money audit on the Tax Administration Division of the Department of Finance. We stated in the Auditor General's Report that we had reservations about the number of sales tax compliance audits. At that time ten audit positions were vacant which represented one quarter of the Division's audit positions. For each dollar spent on audit activities, \$6.42 of sales tax revenue was found. We questioned whether enough resources were being allocated to this activity.

**3.5** In this 1992 review we also commented on collection activities. We recommended that the Division reassess its approach to enforcement including the use of interest, penalties, audits and other methods in order to encourage voluntary compliance.

**3.6** Two key observations coming from this 1992 audit were that *“In some cases, efforts to reduce costs in the Division may be at the expense of revenue generation”* and *“the Division needs to establish procedures to measure and report on its effectiveness.”*

**3.7** In our 1997 Report we expressed concern about the increase in the accounts receivable balance. Between April 1995 and November 1996 the dollar value of the accounts receivable had increased almost 50%. We have also commented in our 1997 and 1998 Reports that the Department lacked a good basis for determining the amount of these receivables that is uncollectable.

**3.8** The factors above and the risk that these areas would be overlooked due to the replacement of provincial sales tax caused us to select the audit and collection of Consumption Tax for review.

**3.9** We were also interested in reviewing the collection procedures from the standpoint of being able to make observations and recommendations that may be appropriate to collection efforts in other areas and not just the collection of unpaid sales tax.

## Scope

**3.10** Our audit objective was to review the economy and efficiency of the accelerated efforts to identify unassessed provincial sales tax and to collect outstanding sales tax. In addition, we reviewed whether the Department has established and reported satisfactory performance measures for these areas.

**3.11** In carrying out this objective, we developed four audit criteria for sales tax audit and six criteria for the collection of sales tax to assist in defining our work. We reviewed these criteria with our departmental contacts and obtained substantial agreement prior to beginning fieldwork on this project.

**3.12** We carried out a number of audit procedures to assess compliance with these criteria. The audit procedures included detailed interviews with Department staff; examination of policies and procedures; reviews of similar operations in other provinces; examination of submissions to Board of Management; review of Public Accounts and the Department’s Annual Report; and a detailed review of collection procedures applied to a sample of thirty sales tax receivable accounts. The findings, recommendations and conclusions from our audit work are organized by the respective criteria in the sections that follow.

## Results in Brief

**3.13** The Department made a reasonable plan to audit all significant provincial sales tax accounts within a reasonable time following the termination of the Consumption Tax.

**3.14** The Department did monitor its progress with respect to implementing the audit of sales tax accounts.

**3.15** Suitable performance information for the auditors and the audit effort as a whole was established and monitored. However, this information was not reported publicly.

**3.16** Revenue from Consumption Tax audits should have been shown separately in the Main Estimates and Public Accounts. Instead, it was combined with the federally administered HST revenue.

**3.17** The relationship between audit revenue and the cost of the audit effort was monitored and the goal of \$4 of revenue to \$1 of cost was greatly exceeded. The actual return was \$7.64 per dollar spent as of March 1999. The Department should determine what ratio of cost to recovery is optimal and continue the audit effort until this is achieved.

**3.18** The responsibility for the collection of each sales tax account was not clearly assigned throughout the collection cycle.

**3.19** Collection agents were not sufficiently monitored to determine whether collection procedures were applied equitably and consistently.

**3.20** Account information needed for the collection agents to determine the priority and other important details was fragmented or not available.

**3.21** No suitable performance measures for individual collection agents, or the collection program as a whole, have been established or reported. The objectives of the collections program have not been set.

**3.22** We reviewed thirty accounts, and noted shortcomings in the collection effort. There could be improvements in the timeliness of collection procedures.

**3.23** Write-offs of uncollectable accounts should be made more promptly to enhance accountability and improve financial reporting.

**3.24** Key information on bad debts arising from non-payment of sales tax is not provided to other departments to affect future payments or other dealings with the Province.

## **Final Audit of Consumption Tax Accounts**

**3.25** In the four years preceding 31 March 1997, the sales tax audits had been uncovering approximately \$14 million per year in unreported tax revenue. The audits generating these receivables typically applied to the previous five or more years of sales tax. This indicated that a significant amount of revenue remained to be assessed after the tax was replaced on 1 April 1997. Our criteria addressed the planning, conducting and reporting of this special Consumption Tax audit effort.

## **Effective Planning for the Special Audit Effort**

**3.26** As with any audit effort, proper planning is a key to successful results. The need for planning was perhaps magnified in these circumstances. That is, the audit effort had to be carried out in a compressed period of time due to the replacement of the Consumption Tax with the HST. Our first criterion addressed the need for planning as follows:

*A reasonable plan should be made to audit all significant provincial sales tax remitters within a reasonable time frame following the termination of the Consumption Tax.*

**3.27** Adequate initial planning is required to establish goals for the program and resources needed to meet these goals. This planning should address the principles of completeness and timeliness in the search for unassessed revenue.

**3.28** The Department had prioritized its listing of approximately 20,000 accounts into 7,000 moderate to high risk accounts based on the following factors: average returns; amount assessed in the last audit; and time since the last audit. The Department then applied an average hour per audit factor to determine how many hours were required to audit these accounts. In order to improve collectability, to avoid simultaneous audits by HST auditors and to minimize inconvenience to the vendors, the Department determined two years was a reasonable time limit to complete this Consumption Tax windup audit effort. From these factors the Department determined that they needed 44 additional personnel for the two-year period. The Department sought approval from the Board of Management for additional funding.

**3.29** On 31 March 1997 Board of Management approved the hiring of 44 extra personnel for the fiscal years of 1998 and 1999. The extra personnel were hired and the accelerated audit effort began in June 1997.

**3.30** In our opinion the Department met our planning-oriented criterion. The Department made a reasonable plan to audit all significant provincial sales tax accounts within a reasonable time following the termination of the Consumption Tax.

## **Department Monitored Implementation**

**3.31** For the Department to be held accountable for the cost of the audit effort, progress must be monitored and compared to a realistic

goal. We are pleased to report the Department met our second criterion, which stated:

*The Department should monitor its progress with respect to implementing the plan, taking appropriate corrective action as necessary.*

**3.32** A goal of auditing 7,000 high-risk accounts was established for this two-year program. The Department has been tracking progress on these audits monthly and reports the auditors have audited 7,240 accounts to the end of March 1999.

**3.33** The auditors have met or exceeded their goal throughout the audit; therefore no corrective action has been necessary.

## Reporting on Performance

**3.34** Our legislation directs us towards commenting on whether or not the government is reporting on the effectiveness of programs. With this in mind, we developed a criterion that stated:

*Suitable performance information for the auditors and the audit effort as a whole should be established, monitored, and reported on a timely basis.*

**3.35** In general, we determined the Department established and monitored performance information for the auditors and the audit effort as a whole. The Department is monitoring performance measures such as audit revenue and the ratio of audit to administrative time by region that is used to gauge the performance of auditors, regions and the audit effort as a whole. One key measure disclosed in the submission to the Board of Management was that the extra cost of the audit effort would be offset by increased revenue. As of March 1999 the cost of the regular and enhanced audit for the last two years was \$5.5 million. It has generated revenue of \$41.8 million during this period.

**3.36** In our opinion, though, the Department only partially met the criterion due to a lack of public reporting of the effort. For instance, there has been no separate disclosure of Consumption Tax revenue in the Province's *Main Estimates* or *Public Accounts* since 1996-97. The Consumption Tax, which amounted to approximately \$30 million in 1997-98, has been aggregated with HST in the *Public Accounts*. The same aggregation has occurred in the Province's *Main Estimates* for 1997-98 and 1998-99. HST is assessed and enforced by the federal government and is remitted to the Province based on a revenue sharing formula. This is quite different than Consumption Tax which is assessed, enforced and collected directly by the Province. This aggregation obscures accountability for both taxes.

**3.37** The Department's annual report does report on the number of audits completed and the revenue generated as a result. However, it does not contrast these figures to expected performance levels. And measures

such as cost per dollar assessed are not disclosed. This audit effort was, in the Department's words "an ambitious undertaking." The Department achieved the coverage goal established at the outset. We believe it should report this performance success more fully.

### **Recommendations**

**3.38** We recommended that the Department provide better disclosure of revenue by source in the Public Accounts and Main Estimates.

**3.39** We also recommended the Department increase its disclosure in its annual report to include a comparison of budget to actual revenue and accounts audited. In addition, the Department should present the cost/revenue payback ratio for the Consumption Tax audit program.

### **Departmental response**

**3.40** *Your first recommendation relates to the Department's aggregate reporting of PST revenue with HST revenue for Main Estimates and Public Accounts purposes since 1997/98. With regard to PST revenue from audits, the Department traditionally viewed the conducting of sales tax audits as primarily a means of measuring and enhancing taxpayer and collector compliance in fulfilling their obligations rather than as a revenue generator. As such, the Department did not deem it appropriate to budget sales tax revenue to be derived from audits. For this reason, it was not included in past Main Estimate PST revenue projections. However, with the implementation of the HST, this practice was changed in that anticipated revenue was budgeted since the purpose of conducting the audits was strictly one of maximizing revenue recovery. In addition, it was not believed necessary to report separately the relatively small amount of PST revenue from the predominant HST revenue. Finally, a significant portion of the \$30 million in revenue referred to in your report actually resulted from the new tax on private transfers of motor vehicles which is imposed by the Harmonized Sales Tax Act.*

**3.41** *The second recommendation concerns increased disclosure in the Department's annual report of budget to actual results from the audit initiative. As the 1998/99 annual report has already been prepared, we will consider inserting an addendum to the report providing this information or, at minimum, include a comprehensive final reporting of the two-year audit effort in the Department's 1999/00 annual report.*

### **Should the Program have Been Extended?**

**3.42** Our next criterion is reflective in nature. It states:

*The relationship between the audit revenue and the cost of the audit effort should be monitored and optimized.*

**3.43** We would expect the Department to systematically reflect on the ratio of audit revenue to audit cost and to continue to ask if the ratio is being optimized. We believe such an exercise is especially important as the program winds down. It adds a second element to the completeness of the audit effort. The audits may have been carried out according to

the plan. The coverage goal may have been met. But measurement of the ongoing effectiveness of the effort may indicate a change or extension in the amount or type of resources is warranted to optimize tax equity and tax revenue generated.

**3.44** The “*Ratio of Net Assessments to Expenses*” has been monitored monthly during fiscal years 1998 and 1999. The Department had an unofficial goal of \$4 of revenue to \$1 of expenditure. This goal was not set in relation to any industry standards or additional costs of collection. Therefore we are unable to establish if a 4 to 1 ratio represents an optimal audit effort.

**3.45** The actual ratio for this special program has been consistently over \$7 of revenue for every \$1 of cost. At the end of March 1999 the audit effort averaged \$7.64 of recovery per dollar spent. Based on this simple ratio, an additional auditor added at a cost of about \$50,000 would increase revenue to the province by approximately \$380,000.

**3.46** The Department maintains that the returns from audits would greatly reduce now that they have audited the risky accounts. The Department did make a decision to extend the audit effort an additional three months until June 1999 to finish audits in progress at that time.

**3.47** During our discussions with the Department we expressed our concerns that, since the recovery ratio continued right to the end at \$7:\$1, perhaps not enough resources were dedicated to the final few months of the audit effort. We would have expected to see a decline from the \$7:\$1 ratio as the program was winding down, indicating the audit effort was approaching its optimal point. Stopping the program when the results were still generating a \$7:\$1 recovery may seem unfair to the taxpayers that have been audited. And it can result in lost revenue.

**3.48** Since the return on high-risk accounts has been considerably greater than predicted, it is reasonable to assume lesser priority accounts would also have a greater than expected return. In our opinion it would make sense to test the Department’s theory that the return would drop quickly on smaller accounts.

**3.49** We concluded the Department partially meets this criterion. Certainly the relationship between the cost and the dollar benefit of the program was being monitored. However, we cannot conclude that the revenue and audit effort was “optimized.” Since the return has been exceeding \$7 for each dollar spent, we believe the audit effort should continue until the ratio drops to some pre-determined level.

### ***Recommendation***

**3.50** We recommended that the Department determine what the minimum rate of return per audit dollar spent should be and continue the special audit effort until this target is met.



**Departmental response**

**3.51** *In the planning phase of the accelerated audit initiative, account selection criteria was developed to determine the accounts on which a close out audit was considered necessary. The criteria incorporated such factors as:*

- *the average amount of tax remitted monthly by the business coupled with the length of time since the last audit,*
- *businesses registered for five years or more that had never been audited,*
- *the amount of past audit assessments coupled with the length of time since the last audit, and*
- *businesses registered that were not remitting tax.*

**3.52** *From this process, approximately 7000 accounts were identified as requiring a final audit. Accounts that were not selected primarily consisted of those that had received an audit in the past with the results not warranting a further audit at this time. Also, accounts that were considered very low risk, either due to their size or due to the low taxable percentage of their sales, were not selected. The Department believes that the selection criteria adequately addressed any question of fairness between businesses of the same type in terms of those that were to receive a final audit and those that were not.*

**3.53** *The Department also considered it very important that the wind up of the audit process for sales tax accounts be confined to two years in order to minimize the impact on businesses as they converted to the HST tax regime. The audit objectives and the resources necessary to accomplish these objectives were determined on the basis of a two-year initiative. These objectives have now been achieved. A pre-determined rate of return may possibly be obtained should the audit effort be continued on low risk accounts. However, we believe that there is little economic benefit to be gained from continuing since the revenue that would be recovered would not, in our view, be material. In addition, we feel that it would represent an undue imposition on businesses. For the above reasons, the Department is satisfied that the audit initiative was appropriately terminated at June 30, 1999.*

**Collection of  
Consumption Tax  
Accounts**

**3.54** The Sales Tax Collections program also had a significant task to perform. Sales tax receivables as of 1 April 1997 totalled approximately \$84 million. Of this amount \$49.5 million was current and was collected in April 1997, leaving \$34.5 million in old accounts at the outset of the special audit effort. Tax collectors are also responsible for collecting receivables generated as a result of this audit effort. The interest cost to finance these uncollected receivables represents a significant cost to the Province. And the longer the accounts are outstanding, the less likely they will be collected in full.

**3.55** The major source of our audit findings came from a sample of thirty accounts that were over \$10,000 and greater than one year in arrears. The sample therefore focuses on problem accounts and not the majority of accounts that are either small or are collected without incident. To a certain extent, we realize that by focusing on old accounts we are overlooking successes of the collection program. By definition, the “successes” have been collected in full and are therefore no longer outstanding.

### **Responsibility Not Always Clearly Assigned**

**3.56** Our first criterion for collection addresses initial accountability for the application of the collection process. Management must clearly assign each account in order that someone can be held accountable for collection action or inaction. In other words:

*Responsibility for the collection of each account should be clearly assigned throughout the collection cycle.*

### **Observations on the period under audit**

**3.57** In the past, collection responsibility was determined by who had possession of the file. In some cases “head office” would send the particulars of the overdue tax account to a regional Collections Office. In turn, some files were sent from the regions to head office in order to commence legal action. Some files were mislaid. Since the files were not accounted for centrally, this system resulted in unclear assignment of responsibility.

**3.58** The collections area also suffered from staff turnover, changes in management and extended sick leave during the period under audit. A further problem occurred when part of the computer system dealing with taxes on purchases was “turned off.” This resulted in a twenty-month period beginning in the winter of 1995 when monthly statements were not sent out to delinquent accounts. In addition, collection officers were not notified that these accounts were in arrears. Therefore in many of these cases no collection activity was performed.

**3.59** These explanations were given to us during discussions of our random sample of thirty delinquent accounts. Twenty-two of the thirty accounts we reviewed had “collection gaps.” In other words, quicker or more decisive action should have been applied to these accounts.

**3.60** In these twenty-two “collection gap” accounts, most had no collection activity within one year. Several of the accounts had gone two years or more without collection activity. For example one account had no collection activity from June 1996 to February 1999. Another had no collection activity since November 1994. A third showed no evidence of collection activity since May 1996. Obviously, one contributing cause to the “collection gaps” was that the responsibility for the collection of each sales tax account was not clearly assigned throughout the collection cycle. The Department did not meet this first criterion.

**Recommendation**

**3.61** We recommended that the Department maintain a listing that indicates who is responsible for collection activities on each receivable account on a monthly basis.

**Recent improvements**

**3.62** The system of assigning accounts for collection appears to be improving. A call centre has been established where overdue accounts are initially sent for collection. Call centre staff phone delinquent accounts within thirty days after the due date. These employees try to get full payment or an agreement to pay the full amount outstanding within a year. If the call centre is unsuccessful, the account is forwarded to the collection officer.

**3.63** On the information systems side, we were informed that as of March 1999, a listing has been produced and distributed to each collection officer that clearly indicates what accounts they should be working on. This is an improvement over what had been used previously.

**Neutrality of Collection Procedures Not Monitored**

**3.64** The tax system depends on people complying with the law. If taxpayers do not believe the law is applied and enforced equitably, they are less likely to co-operate or comply voluntarily. Given this, one can see the importance of a criterion that says:

*The collection agents should apply the Department's collection procedures without bias, and this neutrality of application should be monitored on an ongoing basis.*

**3.65** This criterion addresses fairness and equity in the collection of taxes. A collection system that is perceived as biased and/or grants concessionary terms to certain accounts may soon find an increasing number of accounts refusing to pay.

**3.66** In most of the accounts reviewed the Department did apply the collection tools indicated in the collections policy. However, the timing of the application of these tools was inconsistent. In most cases it appeared that the collection activity should have been performed sooner. For example, seizure of assets was seldom successful since by the time the seizure action took place, often no assets were left.

**3.67** In addition, there was no evidence of a review of the application of collection tools by the collection agents. Without this monitoring the Department cannot determine if collection tools are applied consistently and without bias. The Department lacks a system to monitor the collection efforts of its agents. In short, the criterion was not met.

**3.68** The Department admits that accounts that have the ability to pay are given increased attention. The Department indicated that they take the middle ground between collecting accounts and preventing bankruptcies. They wish to keep the company in business in order to

maximize recovery. The Department informed us they understood how this can be interpreted as bias.

**3.69** We cannot determine if the Department's collection procedures are applied without bias since the prescribed collection procedures are at the discretion of the collector. The collection policy does not give definite deadlines as to when each procedure should be applied.

**3.70** Likewise the penalty and interest application is subject to discretion. Subsection 38.1 of the Revenue Administration Act states that:

*The Commissioner, with the approval of the Minister, may in accordance with the regulations waive in full or in part a requirement under this Act to pay interest or a requirement under section 32 to pay a penalty.*

**3.71** Whether or not the taxes are actually owed is also subjective. Subsection 4(2) of the Revenue Administration Act also states:

*The Commissioner may from time to time and at such intervals as he may consider reasonable, assess and reassess any tax payable under a revenue Act by any taxpayer, and may vacate or vary any assessment or reassessment, and thereupon the tax so determined shall, for the purposes of sections 12 and 22, become due and payable by the taxpayer.*

**3.72** Since the collection system allows for a significant amount of discretion, we cannot say that the collection procedures employed on any of the thirty accounts violated the policy or the Act. We did, however, find cases where the collection processes applied to some accounts appeared to be more lenient than collection processes on others. In the previous section we referred to "collection gaps" in twenty-two of the thirty items in our sample. Certainly those remaining accounts that were actively pursued for collection could have reason to question the equity of the system.

**3.73** Payment arrangements and forgiveness of interest and penalties can potentially introduce inequities into the tax system. They may be perceived as constituting special treatment for individuals who have not paid taxes owing on time.

**3.74** The Department's goal in introducing payment arrangements and/or forgiveness of interest and penalties appears to be to collect the maximum possible from these delinquent accounts. Our sample of thirty accounts showed nine such arrangements. While these arrangements were in effect, these nine accounts often collected additional taxes from customers and failed to remit. A number of these nine accounts have subsequently gone bankrupt, resulting in an increase in uncollectable taxes.

**3.75** In one sample item, a vendor was allowed to continue adding to the amount that was owed to the Province while dishonouring several payment agreements on past debts. The Province allowed a debt of \$12,000 in September 1994 to increase to \$150,000 by April 1997. Since the tax owing for January to March 1997 has never been audited, the true amount of the debt could exceed this amount. One could argue full collection of this amount, including penalty and interest, is necessary to restore equitable treatment of tax-paying competitors in the same market.

**3.76** An offer was made to the Department to settle this account for \$30,000. The Department counter offered in February 1999 for \$70,000. The Department's counter offer would cover the actual tax owing of approximately \$47,000. A significant portion of the interest and penalty would be set aside.

**3.77** Another sample item had a balance owing of \$21,000. The Department has agreed to settle for five yearly payments of \$3,000. In another sample a payment agreement was entered into to forgive 50% of the interest provided monthly payments are made.

**3.78** The Department's position is that special arrangements are given based on the financial position of the taxpayer. Each is considered on its own merits and subjective judgements are made as to what action should be taken. In our opinion, though, inequities may result from these decisions.

**3.79** Companies that are allowed to continue operating despite failing to remit taxes create a competitive disadvantage for other businesses in the same market who are collecting and submitting their taxes on time. There are only so many sales to be made in a particular market-place, and when they are being made by companies who collect but do not remit sales tax, they represent unfair competition to the company which collects and remits sales tax, in accordance with the regulations.

#### *Recommendation*

**3.80** We recommended that collection procedures be clearly prescribed and documented. Deviations from these should be explained and immediately brought to the attention of management. Circumstances that influence the granting of payment arrangements and the forgiveness of penalty and interest should be clearly defined.

#### *Departmental response*

**3.81** *The Revenue Division of the Department developed and implemented a collection procedure manual several years ago. This manual gives basic guidelines on routine collection procedures that are followed for the majority of accounts collected. However, there are certain accounts for which hard and fast rules are difficult to apply. In certain cases, standard collection procedures could force a bankruptcy to occur, in which case the Province loses its entire receivable since consumption taxes are unsecured. In situations such as this, the*

*Department has preferred to follow a more balanced approach in attempting to maximize its collections while also helping businesses to remain viable. The Department does plan to develop more clearly defined policies associated with granting payment arrangements and supporting recommendations for penalty and interest remissions.*

### **Collection Officers Need Better Information**

**3.82** The more easily and accurately the collector can determine priority, risk factors, collection action that has been performed to date, and collection action that should be performed, the more effective the collection effort should be. Therefore, we developed a criterion as follows:

*Priority, collection history and other important account information should be readily available to the collection agents to assist in efficient conduct of their work.*

**3.83** As mentioned previously, it is only in the last eighteen months that collection agents have begun using an aged listing of outstanding accounts. Apparently, this listing brought to light many accounts that no one had been working on. Prior to this listing, possession of the file was the main indicator of who was responsible for the account.

**3.84** It is up to the collection agent to determine the priority of each account and what collection procedure should be applied. Systems in other provinces send collection officers a prioritized listing of accounts. These systems assign this priority based on collection history and amount outstanding. The collection agent is to follow up on these accounts within the first quarter of each month. Account history seems to be more readily available to collection agents in these other jurisdictions.

**3.85** At the time of our audit the Department's collection history and account information came from the following sources:

- the "CDI" computer screen that is updated by collection agents and call centre staff;<sup>1</sup>
- a computer screen that gives billing, payment and account balances;
- a contact history report which is also updated by collection agents and call centre staff;
- a diary (manual or computerized) maintained by collection agents indicating the date and action to be taken in the future on accounts;
- manual phone contact records maintained by the manager of collections and others; and

---

1. The CDI and CTXS account screen has been replaced as of 31 March 1999 as it was not Y2K compatible. An "Oracle" computer system has replaced the account screen.

- the physical collection file containing documentation of significant collection action taken and letters exchanged. There may be more than one of these files for an account at any point in time.

**3.86** Collection problems are compounded by a few cases of missing information among the existing sources. For three of the thirty sample items we had specific concerns about missing information in the files that had, or could likely have had, a significant effect on the collection of the account.

**3.87** The most notable example was one sample item which did not have documentation for the first six to eight months of collection activity. It appears a full file had gone missing. We were told that among the documents in the lost or missing file was a \$10,000 bond the Department obtained as security on the account. Although the taxpayer did not remit the taxes owing, the Department could not cash the bond since it could not be found.

**3.88** Our analysis shows that the account information needed by collection agents was fragmented or not available. Again, a criterion for collections is not met. This information deficit would have affected the efficiency of the collection effort.

#### *Recommendation*

**3.89** We recommended that the Department's collections information system provide quick access to suggested priorities, courses of action and pertinent account information.

#### *Departmental response*

**3.90** *The Department agrees with the importance of providing collection officers ready access to historical payment data and relevant current information that could influence beneficially the collection effort. Coupled with revised collection procedures, auditors will be required to provide in their audit reports a statement concerning the financial position of the taxpayer or collector and any other information that could assist in the collection of liabilities established.*

#### **Performance Information**

**3.91** Our fourth criterion focused on performance information as follows:

*Suitable performance information for individual collection agents, and for the collection program as a whole, should be established, monitored and reported. For example, the relationship between collection and the cost of collection should be monitored and optimized.*

**3.92** This criterion addresses both the accountability of the collection agents to the Department and the accountability of the Department to the Legislative Assembly.

**3.93** We determined that performance information for individual collection agents has not been established. There are no work plans for

the agents. The agents indicated that no measures of performance have been communicated to them. None of the collection agents have had formal performance appraisals. There is informal feedback to the agents on how they are doing, but the system does not generate objective evidence on which to base this feedback.

**3.94** When we moved to the program as a whole, we noted the Department could not provide us with any measurable goals or objectives for collections. The Department does track some information on the makeup of the receivable balance but not on the evaluation of the collection program. Goals or targets have not been established to match against actual results.

**3.95** In our discussions with staff we recommended two specific performance measures that are common to collection activities. The first measure is the collection rate for overdue taxes. This requires that the amount of the receivable that goes into arrears each year is established and the amount of the arrears that are collected within the year is also determined. In a recent Province of British Columbia publication, the collection rate for overdue taxes was stated at 59.3%.

**3.96** The other measure we suggested is to take the amount of arrears collected and the total cost of the collection program to find a cost per dollar collected. The Province of British Columbia publication indicated a ratio of three cents per dollar collected. The goal for the Federal Collection Service was five cents per dollar collected.

**3.97** We asked the Department to calculate these figures for us. The Department was able to determine that cost of collection for 1998-99 was \$454,000. The Department could not determine the amount of arrears that were collected within the year. The Department was therefore unable to provide us with either performance measure as both required a figure for arrears collected.

**3.98** With respect to this cost figure, it should be noted the cost of collection activities is not separately coded in the Province's accounting system. The Department therefore was unable to determine if the resources applied to the collection effort had increased or decreased over recent years.

**3.99** The main public reporting of the collection activity was in the Department's annual report for 1997-98. It indicated only that "a strong effort is being put towards the consumption accounts in an attempt to have the sales tax account completely cleared by the end of December 1999." With the large amounts of receivables still being generated by the special audit effort, and the payment agreements that will not expire for many years, this goal is not realistic.



**3.100** Because of these observations, we concluded the Department does not meet this criterion.

*Recommendation*

**3.101** Formal objectives for the collection activity should be established. Measurable goals such as cost per dollar collected and percentage collected for the collection program should then be established, monitored, and reported. Results should be used to optimize resources dedicated to this task. These goals should be used to establish work plans for the collectors. Regular performance appraisals for the collectors should be done with reference to these work plans.

*Departmental response*

**3.102** *The Department agrees with this recommendation. Over the course of the next year, the Revenue Division will be developing a set of comprehensive performance goals and measures for each of its operational units. Work plans developed for the collection activity will contain specific objectives. An emphasis will be placed on ensuring that individual performance appraisals, as required by the Performance Management System, are completed.*

**Backlog of Accounts to be Written Off**

**3.103** Our fifth criterion addresses both the accuracy of the receivable balance and the Department's accountability for collection action:

*All reasonable collection efforts to collect the maximum amount of tax owing within a reasonable period should be completed prior to write off. When all reasonable collection procedures have been applied, accounts should be written off promptly in the manner prescribed by governmental policy.*

**3.104** When an account is no longer deemed collectable, it should no longer be shown as an asset. This is consistent with the Province's own policy and the recommendations of the Canadian Institute of Chartered Accountants. Government policy enhances accountability for the collections process since, prior to an account being written off, the name of the uncollectable account, as well as information on the collection effort, is presented to Executive Council.

**3.105** In January 1999 the Department believed that 27% of the receivable balance was composed of bankrupt accounts or accounts due to be written off. We identified twelve out of the thirty accounts in our sample (40%) that should have been written off. Therefore, we concluded the Department had not met this criterion. A review of these accounts indicated that the likelihood of collection is very remote and the Department was no longer pursuing collection of these accounts. For example, in one case, the director of the company declared personal bankruptcy in November 1995. In another, the company declared bankruptcy in February 1993. Yet both were still awaiting write-off.

**3.106** It should be noted that most of the accounts we identified as needing to be written off also had significant gaps in collection activity.

If prompt collection action had been applied, some of the accounts may have been collected. They may never have reached the write-off stage.

**3.107** The Department indicated that few write-offs have been performed since 1995 and the backlog is being addressed.

*Recommendation*

**3.108 Write-offs of uncollectable accounts should be made more promptly to enhance accountability and improve financial reporting.**

*Departmental response*

**3.109** *Prior to writing off accounts receivable, the Department exhausts all available means for obtaining payment. Progress has been made on bringing the existing backlog of write-offs and remissions up to date. The Department will consider instituting procedures that would see write-offs being presented to Executive Council sooner than what is currently done.*

**Information for Future Action**

**3.110** A write-off of an account does not relieve the person or company from owing the debt to the Province. Therefore, the Province needs some record to influence its future dealing with a person or company who has had an account written off. Our final criterion addresses this issue. It states:

*Key information on accounts written off should be retained in a suitable form to allow for future reference and action. This would include documenting information such as the directors of the company, circumstances of the business failure, etc. These records should affect any future credit granted by the Province and/or payments made to the accounts or directors of the company that defaulted.*

**3.111** The Department does have a manual information system in place for recording these write-offs. In all cases the account is entered into a Bad Debt Ledger. In addition, the Department will often have previously registered a memorial of judgement against the account as part of its normal collection procedures. If the company or individual has gone bankrupt, however, the step of registering a memorial of judgement may not be done since the judgement is not enforceable after bankruptcy has been declared.

**3.112** We held discussions with the Department around extending the use of “vendor hold” to accounts it writes off. While an active account is outstanding, the Department issues a “vendor hold” so that funds payable by the Province for purchases from the vendor can be offset against the taxes owing. This provides a practical way to communicate to all departments that there is a problem with the vendor.

**3.113** Accounts that have been written off though are no longer on “vendor hold.” Therefore, at some later date, payments and other transactions may be made between the Province and the delinquent taxpayer without knowledge of the delinquency having occurred.

**3.114** Because of this situation, we felt the Department only partially met the criterion. Key information on bad debts arising from non-payment of sales tax is available; however, this information is not in a format that would effectively allow for future reference or action.

*Recommendation*

**3.115** The Department should maintain a vendor hold on all accounts that have been written off.

*Departmental response*

**3.116** *A vendor hold can be instated for accounts that have been written off in addition to holds that are placed on active accounts. However, before accounts are written off, the collection process would have determined that the account is either bankrupt or has been closed for a lengthy period of time. The likelihood that there would be any current amounts due to the account from the Province would be, in my opinion, somewhat remote.*

**General Concluding  
Comments on  
Collections**

**3.117** It should be noted that the Department appeared to agree with many of our findings in this chapter and is acting to improve its performance in this area. The Department indicated that Collections was the last on the list of areas to be reviewed under the Revenue Management System (RMS) re-engineering effort. When RMS was terminated due to the introduction of the HST (see our 1997 Report), many of the Collections issues had not been addressed. This would be a mitigating factor in the condition of the collection system and the lack of performance measures.

**3.118** While we realize that the significance of the Consumption Tax receivable will be reduced over the next few years, we believe many of our comments and recommendations on collections, and the collection effort, apply to other taxes receivable.