

GAO

Report to the Subcommittee on
Government Management, Information
and Technology, Committee on
Government Reform, House of
Representatives

August 2000

DEBT COLLECTION

Treasury Faces Challenges in Implementing Its Cross-Servicing Initiative



G A O

Accountability * Integrity * Reliability

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Abbreviations

CFO	Chief Financial Officer
DCIA	Debt Collection Improvement Act
FMS	Financial Management Service
OMB	Office of Management and Budget
PCA	private collection agency contractor
PMAC	PCA Monitoring and Control
SOP	standard operating procedures



B-285723

August 4, 2000

The Honorable Stephen Horn
Chairman
The Honorable Jim Turner
Ranking Minority Member
Subcommittee on Government Management,
Information and Technology
Committee on Government Reform
House of Representatives

On June 8, 2000, we testified before your subcommittee on the Department of the Treasury's Financial Management Service's (FMS) implementation of the cross-servicing provision of the Debt Collection Improvement Act (DCIA) of 1996.¹ In our testimony, we reported that for FMS' cross-servicing program to become a fully implemented and mature program, many challenges lie ahead that must be overcome to assure success in the collection of delinquent debt.

In our testimony, we pointed out that the success of FMS' cross-servicing program significantly depends on agencies identifying and promptly referring eligible delinquent debt to Treasury because as delinquent debt ages, the likelihood of collection diminishes. In addition, we identified the following issues that FMS needs to address.

- FMS officials stated that as of September 30, 1999, about 89 percent of the \$59.2 billion of debts over 180 days delinquent were excluded from cross-servicing. However, the accuracy and completeness of amounts reported by agencies including exclusions from cross-servicing were not required to be, and were not, independently verified. In addition, several agencies' reporting of debt balances and related aging was not accurate. For example, a December 1999 report² stated that of the 16 agencies

¹*Debt Collection: Treasury Faces Challenges in Implementing Its Cross-Servicing Initiative* (GAO/T-AIMD-00-213, June 8, 2000).

²*PCIE/ECIE Review of Non-Tax Delinquent Debt*, The President's Council on Integrity and Efficiency, the Executive Council on Integrity and Efficiency, and Department of the Treasury Office of Inspector General (December 1999).

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- reviewed, 5 had inaccurate accounts receivable balances as of the end of fiscal year 1998, and 3 did not accurately age their accounts receivable.
- FMS reported that as of April 2000, about \$3.7 billion of the approximately \$6.4 billion of eligible debt had been referred for cross-servicing. Because the eligible amount is as of a specific date and the amount reported as referred is a cumulative amount covering about 3-1/2 years, these two amounts are not comparable. The cumulative figure includes debts that have been returned to the agencies, such as invalid debts that were not eligible for cross-servicing. For purposes of comparison to the debts eligible for referral amount, such debts should not be included in the eligible debts referred amount.
 - Many of the eligible debts were not promptly referred by the agencies or simply not referred by certain agencies. In addition, the debts referred were not always eligible for cross-servicing because they were not valid and legally enforceable. In an effort to encourage debt referrals, in the spring of 1999, FMS requested written debt referral plans from 22 of the 24 Chief Financial Officer (CFO) Act agencies.³ The plans were of limited use because (1) FMS had no assurance that agencies had properly identified all nontax debts that were eligible for cross-servicing, (2) many of the plans did not include debt amounts or time frames for referral, and (3) FMS did not use the plans to closely monitor actual agency referrals.
 - As the sole operator of a governmentwide cross-servicing debt collection center, FMS had well-developed written standard operating procedures (SOP) for its collectors and requirements for its private collection agency contractors (PCA). However, its staff and some of the PCAs did not always follow established procedures and requirements or effectively use certain debt collection tools. For example, we found no evidence that FMS' collectors had tried to contact about 48 percent of the debtors from our sample after the demand letters were issued. We also found that about 96 percent of the compromised debt files that we selected and tested did not indicate why FMS collectors compromised debts or the basis used to determine how these debts met FMS' criteria for compromising.

³According to FMS officials, no referral plan request was made to the Department of Education because it was deemed to be in substantial compliance with DCIA. In addition, no written request was made to the Department of the Treasury. According to FMS officials, FMS actively worked with the bureaus within Treasury to encourage debt referrals.

FMS recently changed many of the SOP's earlier requirements to perform various collection techniques from "will" be performed to "may" or "should" be performed. In addition, in 1999 FMS changed its written SOP to reduce the 50-day holding period to 30 days for performing cross-servicing procedures before referring the debts to a PCA. These actions and our discussions with FMS officials indicate that FMS is relying heavily on PCAs. However, FMS has not performed an analysis to determine the potential effect such reliance may have on net collections to the federal government. Such analysis may be warranted given that (1) as debts are not actively worked by FMS and are awaiting referral to PCAs, they continue to age and thus typically become more difficult to collect and (2) the federal government pays a 25-percent fee on debt amounts collected by the PCA that the government is not always able to recoup from the debtor.

- Our analysis of FMS' distribution of debt accounts to PCAs from February 1998 through February 2000 showed that one PCA had received a significantly higher percentage of the debts with smaller balances and debts that were less than 1 year delinquent. Collection industry statistics as well as FMS' collection experience to date have shown that collection rates are generally higher on debts with smaller dollar balances and debts that are less delinquent. Concerns relating to the distribution method have been raised by some of the PCAs. During our interviews with the 11 PCAs, we found that when asked how the debts should be distributed, the general consensus among them was that the distribution should consider the characteristics of the debts, such as age of delinquency, type of debt (consumer or commercial), agency referring the debt, and debt balance. Many of the PCAs indicated that stratifying the available debts by agreed-upon characteristics would result in each of the PCAs receiving a proportionate mix of the debts and would foster a more competitive environment.
- The cross-servicing fees FMS charged to agencies referring delinquent debts have not covered FMS' estimated cross-servicing costs and are not likely to in the near future.

This report contains our recommendations to the Commissioner of FMS to assist FMS in implementing a viable cross-servicing operation. We performed our work from April 1999 through May 2000 in accordance with generally accepted government auditing standards. The objectives, scope, and methodology for our work are contained in appendix I and our testimony is reprinted in appendix II.

In commenting on a draft of this report, FMS concurred with most of our recommendations and for several of those recommendations provided comments, which are discussed in further detail in appendix III. However, FMS did not concur with key parts of our recommendation to perform a comprehensive review of the cross-servicing process. Given the results of our testing of a statistical sample of delinquent debts which showed limited collection activity as contemplated under DCIA and FMS' own procedures, we continue to believe FMS needs to assess its debt collection strategy and its standard operating procedures.

Recommendations

To help ensure that eligible delinquent debts are identified and promptly referred by the agencies for cross-servicing and that reporting on the status of delinquent debts by the agencies and FMS are reliable, we recommend that the Commissioner of FMS take the following actions.

- Work with the Office of Management and Budget and the agencies' Offices of Inspector General to develop and implement a process for obtaining periodic independent verification of the accuracy, completeness, and validity of debts reported by agencies as eligible and excluded from the DCIA cross-servicing provisions.
- Revise FMS' reporting of debt amounts referred for cross-servicing to reflect the extent to which eligible debts reported by agencies as of a specific date have been referred to FMS.
- Establish and implement procedures for obtaining, reviewing, and monitoring written debt referral plans from CFO Act agencies and all non-CFO Act agencies with significant accounts receivable activity, to help ensure that (1) the plans are complete, agree with debt amounts agencies have reported as eligible for cross-servicing, and specify timetables for referral of all such debt, (2) actual agency referrals are compared with agency plans, and explanations for any significant deviations from planned referrals or revisions to the plans are obtained from the agencies, and (3) appropriate agency officials are notified and requested to initiate corrective actions when agencies do not substantially comply with their referral plans.

To help ensure that debt collection efforts are efficient, cost-effective, and performed by the most capable entity (i.e., FMS, a PCA, or any agency approved to be a debt collection center) we recommend that the Commissioner of FMS perform a comprehensive review of FMS' cross-servicing process to determine whether FMS' current debt collection

strategy and standard operating procedures are appropriate for optimizing collections. This should be done by

- analyzing the types of debts referred to FMS (e.g., by age of delinquency, debt balance, etc.) and the collection rates experienced on those debts;
- assessing the level of effort FMS collectors should perform by considering the number of collectors assigned, the number and types of debts individual FMS collectors can be expected to effectively cross-service, and fluctuations in the volume of debts referred by agencies and the related impact, if any, on FMS collector workloads;
- revising, if necessary, the SOPs based on the assessment of the level of collection efforts FMS collectors should perform while maintaining appropriate internal controls and accountability over FMS collection efforts;
- identifying specific types of debts, if any, that should be sent promptly to the PCAs for cross-servicing and determining the appropriate level of involvement by FMS collectors on such debts;
- enforcing compliance with established collection procedures performed by FMS collectors and taking appropriate corrective actions when deviations from established procedures are found;
- enforcing compliance with established procedures for FMS staff to monitor PCAs' collection activities and taking appropriate corrective actions when PCAs deviate from established requirements; and
- periodically analyzing FMS' cross-servicing costs and related fee structure.

To help ensure that a proportionate mix of debts is being distributed to the PCAs and competition among the PCAs is more fully promoted, we recommend that the Commissioner of FMS

- work with the PCAs to determine what characteristics of the debts — age of delinquency, type of debt (consumer or commercial), agency referring the debt, or debt balance—should be considered when distributing debts to PCAs for collection and
- establish and implement a process to periodically analyze the distribution and collection data to determine whether adjustment to the distribution model is needed.

Agency Comments and Our Evaluation

In commenting on a draft of this report, FMS concurred with most of our recommendations and for several of those recommendations provided comments, which are discussed in further detail in appendix III. However,

FMS did not concur with key parts of our recommendation to perform a comprehensive review of the cross-servicing process to determine whether FMS' current debt collection strategy and standard operating procedures are appropriate for optimizing collections.

Specifically, FMS stated that its procedure for working a debt at its debt operations center for 30 days prior to sending it to a PCA is appropriate and that it should make full and appropriate use of the private sector. FMS stated that because debts are referred by federal agencies sporadically and randomly, an assessment of the level of effort FMS collectors should perform is impractical. In addition, FMS stated that most workload issues have occurred when new agencies begin to use cross-servicing and refer thousands of their old debts to FMS at one time. Further, FMS stated that it is prohibitively costly for FMS to temporarily staff up for these large numbers of referrals.

One of the very reasons that FMS should perform a comprehensive review of its cross-servicing processes is that large fluctuations in the number of debts referred at any particular time by agencies do occur and can have a significant impact on workloads. As we reported, our tests of the 200 selected debts found that FMS collectors did not always adhere to FMS' cross-servicing SOP. For example, we found that FMS collectors (1) did not always attempt to contact debtors or perform skiptracing to locate debtors who did not respond to demand letters and (2) did not always promptly refer all debts to the Treasury Offset Program or PCAs. FMS pointed out in its comments that FMS relies on the PCAs because they have a greater ability to react to fluctuating volumes. That being the case and in consideration of our testing results, FMS would benefit from a comprehensive review of its cross-servicing process to make informed decisions about how to strategically target its efforts and effectively use available resources, FMS collectors and PCAs.

As we reported, FMS maintains information on debt collection activities for both the FMS collectors and the PCAs. With this information, FMS can perform various analyses of the FMS and PCA debt collection activities, including analyses similar to those we conducted during the course of our work. For example, our analysis of collections of debt found that several agencies had referred debts with large average balances for which no amounts have been collected by either FMS or the PCAs. We also found that collection rates were generally higher on debts with smaller dollar balances and on those that are less delinquent. FMS could use this type of historical information to rank new agency debt referrals that should be

worked on immediately over those that should be worked on as time permits and those that should be immediately referred to the PCAs over those that should be worked on by FMS. Further, through its outreach efforts to encourage debt referrals by agencies, FMS officials stated that it requested debt referral schedules from agencies for fiscal years 2000 and 2001 detailing the specific debt amounts to be referred and the related time frames. FMS could use the information from the agency debt referral schedules to project future workloads to help the FMS collectors and PCAs plan for fluctuations in debt referrals and conduct their operations in a proactive rather than reactive manner.

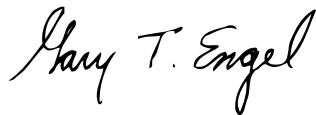
The intent of our recommendation is that FMS establish a management review process whereby FMS' debt collection strategy and related SOPs are evaluated and refined, as needed, to maximize the effectiveness of cross-servicing and to meet the priority management objective of improving debt collection by effectively using the tools provided by DCIA to reduce the amount of delinquent debt and increase collections. Our recommendation was also made to help ensure that

- appropriate actions are taken by FMS management to correct problems and issues identified in our report;
- debt collection procedures make sense based on an assessment of the level and mix of debt collection efforts that should be performed by FMS and the PCAs;
- debts are promptly referred to the entity (i.e., FMS, a PCA, or any other agency approved to be a debt collection center) that has been determined as the most capable of maximizing collections based on an assessment of past performance;
- FMS and PCA debt collection efforts are monitored, established policies and procedures are complied with, and management objectives are being met efficiently and effectively; and
- debt collection efforts are conducted at the least cost to the federal government.

As stated in our report, our analysis of FMS cross-servicing fees and related operating costs found that collection volume would need to rise more than sevenfold above its fiscal year 1999 collections to put FMS cross-servicing operations on a full cost-recovery basis. Carrying out these efforts successfully should help FMS come closer to achieving at least break-even operations for the cross-servicing program.

We are sending copies of this report to Senator Fred Thompson, Chairman, and Senator Joseph I. Lieberman, Ranking Minority Member, Senate Government Affairs Committee; Representative Dan Burton, Chairman, and Representative Henry A. Waxman, Ranking Minority Member, House Committee on Government Reform; the Honorable Jacob J. Lew, Director, Office of Management and Budget; the Honorable Lawrence H. Summers, Secretary of the Treasury; Donald V. Hammond, Fiscal Assistant Secretary, Department of the Treasury; Richard L. Gregg, Commissioner, Financial Management Service; the Honorable Jeffrey Rush, Jr., Inspector General, Department of the Treasury; and other interested parties. Copies will be made available to others upon request.

Please contact me at (202) 512-3406 if you or your staff have any questions on this report. I can also be reached by e-mail at engelg.aimd@gao.gov. Key contributors to this assignment were Kenneth R. Rugar, Paula M. Rascona, Matthew F. Valenta, Michael S. LaForge, Gladys Toro, and Sophia Harrison.



Gary T. Engel
Associate Director
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Objectives, Scope, and Methodology

Our objectives were to determine (1) the status of nontax delinquent debts that agencies have referred to Treasury for cross-servicing and Treasury's actions to encourage these referrals, (2) Treasury's cross-servicing process for collecting referred debts, (3) Treasury's method for allocating debts to PCAs for collection, and (4) Treasury's estimated cross-servicing costs and related fees earned on collections.

To accomplish our first objective, we interviewed FMS officials concerning the processes and procedures that were used to encourage federal agencies to refer delinquent debts for cross-servicing. We obtained and reviewed reports that FMS used in working with agencies to identify debts that were eligible for cross-servicing and to encourage agencies to refer all such debt. These reports included the *Debt Performance Indicator Report and Summary Analysis of Delinquent Debt for the Federal Government*. We also obtained and reviewed written debt referral plans that had been submitted to FMS by certain federal agencies.

To accomplish the second objective, we interviewed FMS officials on their processes for collecting delinquent debts. We reviewed all pertinent policies and procedures including FMS' *Cross-Servicing Implementation Guide* (April 1997, Revised January 1999); *Standard Operating Procedures: Debt Collection* (December 1998, Revised May 1999 and February 2000); the *Private Collection Agency Operations and Procedures Manual* (March 1998, Revised March 1999); and FMS' contract with PCAs.

To determine whether FMS collectors performed collection activities and used appropriate collection tools in accordance with FMS' established policies and procedures, we randomly selected a sample of 200 delinquent debts from a population of debts referred for cross-servicing from April 1, 1998, through May 31, 1999.¹ We also used this sample to test, when applicable, whether PCA contractors documented performance of required debt collection activities in their respective debt collection systems as required by their contracts with FMS. In addition, we selected a random sample of 78 debts from a population of debts that had been compromised² by FMS collectors to test whether the collectors followed FMS' policies and procedures when compromising debts.³ We reviewed debt history files, including Debt History Reports generated by FMS' cross-servicing computer system, to determine whether FMS collectors performed the required collection activities (e.g., telephoning the debtor, obtaining support for compromises, etc.).

To accomplish the third objective, we obtained a written description of the debt account distribution methodology from FMS and its contractor and compared it with the distribution process portion of the PCA Monitoring and Control (PMAC) software source code. During our fieldwork, FMS tested its distribution methodology by manually distributing a sample of debt accounts and distributing those same accounts using a test copy of the PMAC system. We reviewed documentation of FMS' test for reasonableness. We also obtained copies of pertinent data from the PMAC system (from February 1998 through February 2000) and performed various analyses of the debt account information, including distribution of the debt accounts to the PCAs, age of delinquencies, and collection rates.

To accomplish the fourth objective, we interviewed FMS officials on their methodology for estimating costs and recognizing fee revenues. We reviewed the contractor's study that Treasury used to estimate costs for fiscal year 1999 to ensure that all significant relevant costs were included in the estimate. We also obtained and analyzed fee revenue and collection

¹We selected debts with referred balances greater than \$100 because this is the dollar threshold amount of debt FMS refers to its PCAs.

²A debt compromise involves the government agreeing to accept less than the full amount of its claim in satisfaction of the entire debt.

³The population sizes from which we selected referred delinquent debts and compromised debts were 61,269 and 644, respectively. Both samples were selected to allow projections of key results to the populations from which they were drawn with 95 percent confidence.

information for fiscal year 1999 from FMS' cross-servicing databases and used this information to determine the amount of increase in collections necessary for FMS to fully cover its costs.

We performed our work in accordance with generally accepted government auditing standards from April 1999 through May 2000. We did not independently verify the reliability of certain information provided to us by FMS (e.g., estimated costs, debts eligible for cross-servicing, total debts referred for cross-servicing, and information in FMS' debt referral and collection databases). We requested comments on a draft of this report from the Commissioner of FMS. FMS' comments are discussed in the "Agency Comments and Our Evaluation" section of this report and reprinted in appendix III.

GAO's June 8, 2000, Testimony

GAO

United States General Accounting Office

Testimony

Before the Subcommittee on Government Management,
Information and Technology, Committee on Government
Reform, House of Representatives

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DEBT COLLECTION

Treasury Faces Challenges in Implementing Its Cross- Servicing Initiative

Statement of Gary T. Engel
Associate Director, Governmentwide Accounting and
Financial Management Issues
Accounting and Information Management Division



GAO/T-AIMD-00-213

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear before your subcommittee today to testify on the Department of the Treasury's progress in implementing the cross-servicing provision of the Debt Collection Improvement Act (DCIA) of 1996. As you know, the Director of the Office of Management and Budget (OMB) designated the implementation of this legislation, which your subcommittee was highly instrumental in passing, one of the Priority Management Objectives in the government's efforts to modernize and improve federal financial management.

DCIA includes several tools to facilitate collection of defaulted obligations to the federal government. Today, we are focusing on the collection of nontax delinquent debt. Among the options available for recovering these debts are (1) Treasury's consolidated federal payment offset program,¹ which the Financial Management Service (FMS) reported collected over \$2.6 billion in federal nontax debts and state child support debts in fiscal year 1999, (2) wage garnishment, for which Treasury has issued a final rule and is in the process of implementing, and (3) the transfer of nontax debt over 180 days delinquent to Treasury for collection action, known as "cross-servicing." For this hearing, you asked us to address, the effectiveness of Treasury's use of the latter tool, cross-servicing, through its FMS. FMS' success in implementing its cross-servicing program, which focuses on debts that federal agencies have been unable to collect, significantly depends on federal agencies accurately and completely identifying their nontax delinquent debt that is eligible for referral to the program and promptly referring such debt.

As you requested, I will discuss (1) the status of nontax delinquent debts² that agencies³ have referred to Treasury for cross-servicing and Treasury's actions to encourage these referrals, (2) Treasury's cross-servicing process for collecting referred debts, (3) Treasury's method for allocating debts to private collection agencies (PCA) for collection, and (4) Treasury's estimated cross-servicing costs and related fees earned on collections.

¹The Treasury Offset Program (TOP) offsets federal payments such as tax refunds, vendor and miscellaneous payments, and federal retirement payments against federal non-tax debts, states' child support debts, and certain states' tax debts. For fiscal year 1999, most of the TOP offsets were from tax refunds.

²In this testimony, "debts" refers to nontax debts over 180 days delinquent.

³In this testimony, "agencies" refers to federal agencies.

FMS has taken several steps to encourage agencies to refer eligible debt and increase collections. However, the results thus far have been limited partly due to much of the eligible debt not being promptly referred and the age of the debts referred generally being significantly older than 180 days delinquent. For example, our analysis of debts referred since the inception of the program through May 1999 showed that almost one half of the dollar value of the debts referred were over 4 years delinquent at the time of referral. FMS reported that approximately \$46.4 billion of debts were delinquent over 180 days as of September 30, 1998. However, primarily due to a significant amount of these debts being reported by the agencies as excluded from cross-servicing requirements, through April 2000, FMS reported only about \$3.7 billion has been cumulatively referred to it since the cross-servicing program began in September 1996. From the inception of the program through April 2000, FMS reported that about \$54 million has been collected by its collectors and the PCAs on these referred debts.

We identified the following key issues related to the implementation of the cross-servicing provisions of DCIA.

- Several agencies' reporting of debt balances and related aging was not accurate, and the accuracy and completeness of significant amounts reported as exclusions from cross-servicing were not required to be and were not independently verified. For various reasons, many debts eligible for referral by certain agencies were delayed in being referred or simply not referred even though FMS took steps to encourage agencies to refer such debt. In addition, even when agencies referred debts, the debts were not always valid and legally enforceable and thus not eligible for cross-servicing.
- DCIA authorized Treasury to designate other government agencies as debt collection centers based on their performance in collecting delinquent claims owed to the government. Treasury established standards for agencies that wanted to be a debt collection center. The Departments of Education and Health and Human Services were granted waivers by Treasury to the cross-servicing provision of DCIA, which allows these agencies to take collection action on certain classes of their own debts. Three agencies have applied to be governmentwide debt collection centers, but were not found by Treasury to have the needed capabilities. Today, only FMS is operating a governmentwide cross-servicing debt collection center. In operating its center, we found that FMS had well-developed standard operating procedures (SOP), however our testing showed that its staff did not always follow them or properly use certain

collection tools, such as skiptracing⁴ activities to locate the debtor. For example, for 96 of 200 debts we statistically selected and reviewed, other than the initial issuance of demand letters, we found no evidence that FMS' collectors tried to contact the debtors, as required by the SOP.

FMS recently changed many of the SOP's earlier requirements to perform various collection techniques from "will" be performed to "may" or "should" be performed. In addition, in 1999 FMS changed its SOP to reduce the 50-day holding period to 30 days for performing cross-servicing procedures before referring the debts to a PCA. These actions and our discussions with FMS officials indicate that FMS is placing increased reliance on PCAs. However, FMS has not performed an analysis to determine the potential effect such reliance may have on net collections to the federal government. Such an analysis may be warranted given that (1) as debts are not actively worked by FMS and are awaiting referral to PCAs, they continue to age and thus typically become more difficult to collect and (2) the federal government pays a 25 percent fee on debt amounts collected by the PCA that the government is not always able to recoup from the debtor.

- FMS developed a methodology for distributing debts to PCAs for collection that FMS intended to be performance based. For each distribution, FMS placed all the debts available into a pool and applied a systematic process to distribute the debts to the PCAs. Our analysis of the debts found that the debts within each distribution's pool were generally not of the same composition (i.e., not of the same debt balance or age of delinquency). This factor contributed to the distribution results experienced by FMS. Our analysis of FMS' distribution of debt accounts to PCAs from February 1998 through February 2000 showed that one PCA had received a significantly higher percentage of the debts with smaller balances. Specifically, debts distributed to this PCA had average balances of \$11,436, while the overall average balances of debt accounts distributed to PCAs were \$20,845. In addition, in many of the age of delinquency categories (i.e., less than 180 days, 180 days to 1 year, etc.) this PCA had the smallest average debt balances and had received a significant percentage of the total number of debts distributed that were less than 1 year delinquent. Collection industry statistics as well as FMS' collection experience to date have shown that collection rates are generally higher on debts with smaller dollar balances and that are less delinquent.

⁴Skiptracing involves the use of information sources including credit bureau reports, Internet resources, utility companies, motor vehicle departments, spouses or relatives, voter registration offices, and directory assistance to locate delinquent debtors.

Concerns relating to FMS' distribution method have been raised by some of the PCAs. During our interviews with the 11 PCAs, we found that the general consensus among them when asked how the debts should be distributed was that the distribution should take into consideration the characteristics of the debts, such as age of delinquency, type of debt, agency referring the debt, and debt balance. Many of the PCAs indicated that stratifying the available debts by agreed-upon characteristics would result in each of the PCAs receiving a proportionate mix of the debts and foster a more competitive environment.

- FMS has not covered its cross-servicing costs through related fees collected and is not likely to in the near future. Based on FMS' own estimated cross-servicing costs and using the current fee structure and FMS' fiscal year 1999 collection experience, we determined that collection volume would need to rise over sevenfold to put this operation on a full cost-recovery basis.

We performed our work primarily at FMS and its Birmingham Debt Management Operations Center (BDMOC). We conducted interviews with FMS officials and representatives of FMS' eleven PCAs and the American Collectors Association and reviewed pertinent policies, procedures, databases, and reports related to cross-servicing. We also statistically selected and performed detailed testing on certain debts that had been referred for cross-servicing from April 1, 1998 through May 31, 1999. In addition, we analyzed FMS' methodology for distributing debts to PCAs and reviewed certain FMS cross-servicing fee and estimated cost data for fiscal year 1999. We did not independently verify the reliability of certain information provided to us by FMS (e.g., estimated costs, debts eligible for cross-servicing, total debts referred for cross-servicing, and information in FMS' debt referral databases). We performed our work in accordance with generally accepted government auditing standards from April 1999 through May 2000.

In the rest of my statement today, I will discuss the results of our work and highlight challenges that FMS faces in implementing a viable cross-servicing operation.

Referral of Federal Debts for Cross-Servicing

According to FMS officials, the amount of debts over 180 days delinquent totaled about \$59.2 billion as of September 30, 1999. Of this amount, about \$52.8 billion or about 89 percent was excluded from cross-servicing, resulting in \$6.4 billion eligible for referral to FMS for cross-servicing. This information was provided to us on June 2, 2000, and the eligible for referral and percent of debt excluded amounts are not significantly

different from the prior year. As such, we did not have sufficient time to review the details supporting these data and much of our testimony regarding identifying debts eligible for cross-servicing and debts excluded from cross-servicing requirements is based on delinquent debt information reported for fiscal year 1998.

DCIA requires agencies to refer all eligible nontax debt that is over 180 days delinquent to FMS for cross-servicing. FMS reported that at September 30, 1998, federal agencies held \$46.4 billion of debt over 180 days delinquent. Based on information obtained from the 24 agencies covered by the Chief Financial Officers Act of 1990 (CFO)⁵ and FMS' own estimates for non-CFO Act agencies, FMS reported that about 85 percent, or \$39.6 billion, of the debt as of September 30, 1998, was not eligible for referral to the cross-servicing program because of various exclusions, such as foreclosures and bankruptcies.

Our analysis showed that the debts agencies refer to FMS are generally well over 180 days delinquent. Further, we noted problems in the reporting of delinquent debt balances and related aging by certain agencies. We also identified problems with FMS reports on the status of delinquent debts governmentwide.

FMS reported that as of April 2000, about \$3.7 billion of the approximately \$6.4 billion of eligible debt had been referred for cross-servicing. Because the eligible amount is as of a specific date and the amount reported as referred is a cumulative amount covering about 3-1/2 years, these two amounts are not comparable. In addition, we found that agency-referred debts were not always valid and legally enforceable and thus not eligible for cross-servicing.

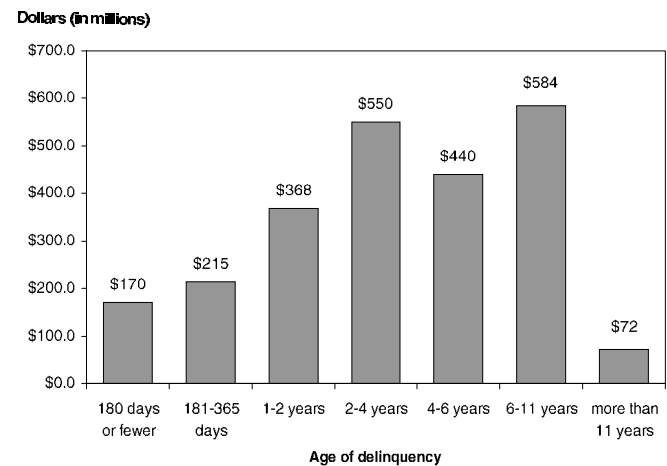
These reporting problems, coupled with the lack of independent verification of the completeness and accuracy of debt exclusion amounts, make the reliability of these reported amounts questionable. Lack of reliable identification and prompt referrals of eligible debts by the agencies to FMS is likely to result in lost opportunities for the government to recover amounts owed.

⁵The CFO Act, as expanded by the Government Management Reform Act, covers the federal government's 24 largest departments and agencies, which account for 99 percent of federal expenditures.

Age of Debts Referred

Agencies are not promptly referring debts as soon as they are eligible for cross-servicing. Figure 1 shows our analysis of the debts referred since the inception of the program through May 1999. This analysis shows that about \$1.1 billion (or about 46 percent) of the \$2.4 billion of debt referred during this period was over 4 years delinquent at the time it was referred to FMS for cross-servicing.

Figure 1: Dollar Amount of Debt by Age of Delinquency



Source: GAO's analysis of Treasury's cross-servicing database through May 31, 1999.⁶

A critical factor in FMS' success as a debt collection center is that all debts eligible for cross-servicing are completely and accurately identified. In addition, once identified by the agencies, debts need to be promptly referred for cross-servicing because, as industry statistics have shown, the likelihood of recovering amounts owed decreases dramatically with the age of delinquency of the debt. Thus, the old adage that "time is money" is very relevant for this effort.

⁶The number of days delinquent for debts with the above time frames is given in years delinquent, representing days within that time frame. For example, 1-2 years delinquent represents 366-730 days, 2-4 years delinquent starts the next period, 731-1460 days and so on.

Using cross-servicing collection rates for delinquent debt obtained from a 1998 study conducted by a FMS contractor, we estimated collections on debts totaling about \$1.8 billion that were referred from the inception of the program through May 1999.⁷ Our analysis showed that estimated collections on these debts ranged from about \$40 million to \$75 million.⁸ Based on our review of FMS' collections database, we determined that FMS collected about \$27 million on debts that were referred for cross-servicing during this same time period.⁹

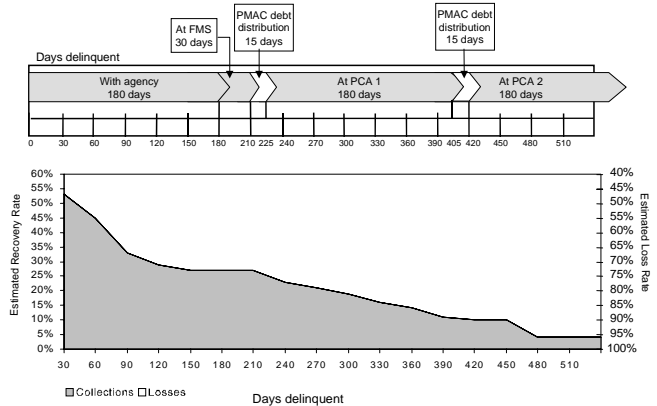
Figure 2 represents a timeline of the standard process involved in the referral of debts to FMS and subsequently, as applicable, to PCAs. In effect, this figure represents the minimum timelines for referral and collection efforts. Accordingly, it reflects the optimum scenario for cross-serviced debt, not what is actually taking place, as reflected in part by figure 1. For example, as noted in figure 1, many debts are much older than 180 days delinquent when they are referred to FMS. Also, as discussed later in this testimony, we identified delays throughout much of the process.

⁷We obtained FMS' cross-servicing collection data from inception of the program through March 2000. To allow sufficient time for collection action by FMS collectors and PCAs, we analyzed those debts referred to FMS through May 1999.

⁸Because of database limitations, we made conservative assumptions in estimating expected collections on debts referred through May 1999. Specifically, we excluded about \$3.7 million of TOP offset collection amounts because FMS collectors or PCAs cannot collect on debts that have already been collected. Also, we excluded debt amounts for most debts returned to the agency. We assumed that these debts totaling about \$547 million were invalid at the time of referral; thus, these debts could not be collected by FMS collectors or PCAs.

⁹An FMS official stated that FMS has identified about \$15 million of active repayment agreements for debts referred from inception of the cross-servicing program through May 1999. However, collection of the full amount under repayment agreements may not be realized because we found that many of the repayment agreements we reviewed during our detailed testing of selected debts referred to FMS for cross-servicing defaulted.

Figure 2: Declining Recovery Rates by Age of Delinquency



Note: FMS uses the PCA Monitoring and Control (PMAC) system to distribute the debt accounts to the PCAs. These distributions are generally made bi-weekly.

Source: GAO's analysis of FMS' collection processes and testimony of the American Collector's Association before the Subcommittee on Government Management, Information and Technology of the Committee on Government Reform and Oversight, September 8, 1995.

Exclusions From Cross-Servicing and Accuracy of Reporting

Agencies provide information to FMS annually on debt amounts over 180 days delinquent in their *Report on Receivables Due from the Public* (hereafter referred to as the *Report on Receivables*).¹⁰ At September 30, 1998, FMS reported that, governmentwide, agencies held \$46.4 billion of debt over 180 days delinquent. However, problems were found with the accuracy and completeness of some agencies' reports of debts over 180 days delinquent, which FMS used to compile its reports.

To help monitor the extent to which agencies are referring eligible debts to FMS for cross-servicing, FMS developed and implemented the *Debt Performance Indicator (DPI)* report for each CFO Act agency. According to an FMS official, for fiscal year 1998, FMS obtained the information on debts excluded from cross-servicing from DPI reports submitted by

¹⁰Certain agencies are also required to prepare this report quarterly.

agencies and discussions with agency officials. FMS used the agencies' *Report on Receivables*, DPI reports, and FMS estimates to compile the *Summary Analysis of Delinquent Debt for the Federal Government*, a government-wide report.¹¹ FMS reported that about 85 percent of the debt or \$39.6 billion was not eligible for referral to FMS because of various exclusions (see table 1).

Table 1: Nontax Debt Eligible for Referral for Cross-Servicing as of September 30, 1998¹²

Characteristics of debt	Amount (in billions of dollars)
Debt over 180 days delinquent	\$46.4
Exclusions:	
Cross-servicing waivers	16.6
In forbearance or in appeals	5.1
At DOJ	4.9
Foreign debt	3.6
In bankruptcy	3.1
In foreclosure	2.4
Department of Defense	1.3
Eligible for internal offset	1.0
Other	0.9
At third party	0.7
Total amount excluded	\$39.6
Amount eligible to refer for cross-servicing	\$6.8

¹¹An explanation of the terms used in this table appears in appendix I.

Source: *Summary Analysis of Delinquent Debt for the Federal Government, Debt Portfolio Analysis for the 24 CFO Agencies*, June 1999, and other FMS reports.

The reliability of amounts reported as excluded from cross-servicing by the agencies has not been independently verified. According to FMS officials, agencies were not required to certify that all information provided to FMS was complete and accurate. Further, these agencies'

¹¹The *Summary Analysis of Delinquent Debt for the Federal Government* (hereafter referred to as the *Summary Analysis*) is included in the *Debt Portfolio Analysis for the 24 CFO Agencies*, which is prepared annually.

¹²In November 1999, Treasury granted an exemption from cross-servicing to the Social Security Administration (SSA) for Supplemental Security Income program debt and debts owed by former child beneficiaries in the Old-Age, Survivors, and Disability Insurance Program. In January 2000, Treasury also granted an exemption to the Small Business Administration (SBA) for disaster loans and regular business loans over 180 days delinquent that are in active workout. The dollar amount of exemptions for SSA and SBA are about \$203 million and \$88 million, respectively.

respective Office of Inspector General (OIG) were not required to and did not audit most of the information, including the exclusion amounts.

We identified problems with FMS' estimates of exclusions for non-CFO Act agencies. In preparing the fiscal year 1998 *Summary Analysis* report, FMS generally estimated the amount of debts that would be excluded from cross-servicing for non-CFO agencies using the CFO Act agencies' aggregate percentages by type of exclusion. FMS estimated exclusions for the non-CFO Act agencies because these agencies were not required to report such information. FMS estimated that of the \$39.6 billion of excluded debt in table 1, about \$3.6 billion (approximately 9 percent) was attributed to the non-CFO Act agencies. We found that FMS' estimation of exclusion amounts was not reliable. For example, FMS estimated the amount of cross-servicing waivers for non-CFO Act agencies to be about \$1.5 billion. Since we found that none of these agencies had applied to FMS for a waiver, the amounts reported as exclusions for cross-servicing waivers were overstated.

On the other hand, FMS' exclusion estimate for bankruptcies for non-CFO Act agencies is understated. Our review of the *Report on Receivables* from the Federal Communications Commission (FCC), a non-CFO Act agency, found that FCC had \$2.3 billion in bankruptcies for debts delinquent over 180 days as of September 30, 1998. As such, FCC's bankruptcy amounts alone are considerably more than the \$300 million bankruptcy amount FMS estimated for all non-CFO Act agencies.

Compounding these concerns are questions concerning the accuracy of the underlying agency reports that FMS uses as the basis for its reports. In December 1999, the President's Council on Integrity and Efficiency (PCIE), the Executive Council on Integrity and Efficiency (ECIE), and Treasury's OIG issued a report titled, *PCIE/ECIE Review of Non-Tax Delinquent Debt*. Among other findings, the report stated that of the 16 agencies reviewed, 5 had inaccurate accounts receivable balances as of the end of fiscal year 1998, and 3 agencies did not accurately age their accounts receivable.¹³ For example,

- The Department of State OIG found that the accounting system at the department did not produce a reliable accounts receivable aging schedule.

¹³Eleven of the 16 agencies included in the PCIE/ECIE review are CFO-Act agencies. Two large CFO-Act agencies, the Departments of Health and Human Services and Agriculture, did not participate in the review.

- In reporting on its audit of the fiscal year 1998 Veterans Affairs (VA) Consolidated Financial Statements, the VA OIG qualified its opinion on material amounts of accounts and loans receivable due to the inadequacy of supporting accounting records. Specifically, of the total net debt and foreclosed property of \$4.7 billion, the OIG qualified its opinion on the accounts relating to the Housing Credit Assistance Program, which comprised \$3 billion of the total balance. Further, the Veterans Health Administration's receivable balance of \$440 million was overstated by \$65 million. These inaccurate balances resulted because VA did not consistently follow its accounting procedures and certain of its internal controls were ineffective.

FMS officials recognize the problems with the manner in which the exclusions and eligible debt amounts for cross-servicing were identified. For example, FMS officials stated that for fiscal year 1999 FMS is using the *Revised Report on Receivables* to determine debts eligible for cross-servicing for all agencies, including non-CFO Act agencies. The revised report includes the various exclusion categories which agencies will be required to use to report debt amounts excluded from cross-servicing. According to these officials, FMS plans to require agencies to certify as to the accuracy and completeness of the amounts that they report as excluded from cross-servicing, however, agencies' respective OIGs do not currently independently verify such amounts. Lack of such verification, along with the problems noted in the PCIE/ECIE report regarding inaccurate balances and aging of accounts receivable, raises concerns about the extent to which FMS can rely on agencies' reporting of 180-day delinquent debt and exclusions of debts from the cross-servicing program.

Factors Affecting Agencies' Debt Referrals

According to FMS officials and/or the PCIE/ECIE report, certain agencies have not promptly referred eligible debts for several reasons, including the following:

- Agencies focused their computer programming resources on Year 2000 problems – a decision with which we agree – rather than on cross-servicing systems requirements, such as computer systems' compatibility, so that debt information can be transmitted to FMS electronically.
- Certain agencies had to perform detailed and time-consuming due diligence reviews of the files to identify debts eligible for cross-servicing because such information was not readily available.
- Some agencies delayed referring debts while waiting for FMS to decide whether the agency's request to be designated a debt collection center was

approved. Such decisions were to be rendered within 120 days, but processing time ranged from 10 months to 19 months.

Some specific cases cited in the PCIE/ECIE report are as follows.

- Treasury's OIG selected and reviewed 10 debt case files at Treasury's departmental offices for timeliness of the referral. The average time frame that lapsed after debts were eligible to be sent to FMS was 197 days. According to a Treasury OIG official, this delay involved referrals to TOP and cross-servicing and occurred because Treasury personnel did not properly age the receivable balances.
- The Department of State did not have a routine process to certify and send its debts for cross-servicing after they became eligible. This department was sending debts to FMS for TOP collection actions only once a year, and its officials mistakenly thought that FMS would transfer the department's delinquent debts from offset to cross-servicing.

We also found that even when the agencies referred debts, the debts were not always valid and legally enforceable and thus not eligible for cross-servicing. Based on our analysis of a statistical sample of 200 delinquent debts referred to FMS, 22 delinquent debts were likely invalid or legally unenforceable.¹⁴ Specifically, we found 14 debts that were subsequently returned by FMS to the referring agency because the debts were invalid or involved debtors in bankruptcy. At the completion of our detailed testing, another eight debts had not yet been returned to the agency. Five of these debts involved debtors in bankruptcy, and the other three debtors were deceased.

FMS' Outreach Efforts

FMS encouraged agencies to promptly refer all eligible nontax debts by assisting them in understanding the cross-servicing program and requirements for identifying and referring eligible debts. FMS officials stated that FMS conducted periodic workshops and conferences and met with agency officials. In addition, FMS stated that they took an active role

¹⁴The population of delinquent debts from which our sample was drawn totaled 61,269 debts. Based on our test results, we estimate that 6,740 (or about 11 percent) of the debts were likely invalid or legally unenforceable. We are 95-percent confident that the number of debts that were likely invalid or legally unenforceable was between 4,638 (or about 8 percent) and 9,393 (or about 15 percent) of the population.

in the Federal Credit Policy Working Group¹⁵ to help determine ways to encourage federal agencies to refer eligible nontax debts promptly.

In an effort to encourage debt referrals, in the spring of 1999, FMS requested written debt referral plans from 22 of the 24 CFO Act agencies.¹⁶ The plans were of limited use because (1) FMS had no assurance that agencies had properly identified all nontax debts that were eligible for cross-servicing, (2) many of the plans did not include debt amounts or timeframes for referral, and (3) FMS did not use the plans to closely monitor actual agency referrals.

According to FMS officials, as of the completion of our fieldwork, 21 of the 22 CFO Act agencies had submitted debt referral plans. The Social Security Administration (SSA) did not submit a plan and has not referred any debts to FMS even though information provided by FMS indicates that SSA had about \$444 million of eligible debt for cross-servicing as of September 30, 1998. Five of the 21 agencies reported that all eligible debts had been referred. Ten of the remaining 16 agency referral plans did not contain details on the specific debt amounts to be referred and/or time frames for cross-servicing referrals. For example, one agency submitted a plan stating that all of its components would refer debts for cross-servicing in July and August 1999, but did not mention any specific dollar amounts. Information prepared by FMS as of February 2000 indicated that this agency had referred only \$109,000 of the \$11 million of debt that it had reported as eligible as of September 30, 1998.

According to an FMS official, because some of the agency plans were incomplete, FMS did not closely monitor agencies' adherence to their referral plans. In addition, as long as agencies were referring some debts, FMS generally did not contact agencies about their plans. FMS officials also stated that FMS did not have the authority to assess penalties or take other formal actions against agencies that did not promptly refer their eligible debts. In May 2000, FMS sent letters to 23 of the 24 CFO Act agencies¹⁷ requesting debt referral milestones for fiscal years 2000 and

¹⁵The Federal Credit Policy Working Group provides an interagency forum for resolving DCIA implementation issues such as the debt referrals to Treasury for offset and cross-servicing and performance measures for credit programs.

¹⁶According to FMS officials, no referral plan request was made to the Department of Education because it was deemed to be in substantial compliance with DCIA. In addition, no written request was made to the Department of Treasury. According to FMS officials, FMS actively worked with the bureaus within Treasury to encourage debt referrals.

¹⁷In April 2000, the Department of State provided FMS with an update to its referral plan for fiscal year 2000.

2001. In the letter, FMS enclosed a debt referral schedule for agencies to complete detailing the specific debt amounts to be referred and the related time frames. In addition, FMS has recently been meeting with CFO Act agencies to determine debt amounts eligible for cross-servicing. Further, a FMS official stated that FMS plans to request written referral plans from non-CFO Act agencies and meet with officials from the larger non-CFO Act agencies regarding such plans.

FMS' Cross-Servicing Operations Management

In passing DCIA, the Congress intended, in part, to establish an efficient and effective governmentwide debt collection operation, known as cross-servicing. DCIA authorized Treasury to designate other government agencies as debt collection centers based on their performance in collecting delinquent claims owed to the government.

Since then, FMS has established the Birmingham Debt Management Operations Center (BDMOC) as its primary facility for handling governmentwide cross-servicing operations. This facility was a former FMS payment center that was being phased out as part of Treasury's consolidation of payment operations. Except for efforts to collect on erroneous payments under the former payment center operations, the staff had little prior experience in debt collections. According to FMS officials, FMS trained BDMOC employees before they assumed their debt-collection duties and periodically updated their debt collection training, as needed, on topics such as debt collection techniques and the servicing of particular debts.

Thus far, FMS has not engaged the services of federal agencies with ongoing and experienced debt collection operations to assist in governmentwide cross-servicing debt collection efforts. In December 1996 and October 1999, FMS issued standards allowing agencies to apply to be part of a collection network. The Departments of Education and Health and Human Services were granted waivers by Treasury to the cross-servicing provision of DCIA, which allows these agencies to take collection action on certain classes of their own debts. Three agencies – VA, the Department of Health and Human Services, and the Department of Agriculture's National Finance Center – submitted applications for designation as governmentwide debt collection centers. Treasury denied approval of these agencies primarily because it determined that these entities did not have the needed capabilities. FMS officials stated that they have not received any additional applications for designation as governmentwide debt collection centers.

Oversight of FMS Debt Collectors and PCAs

FMS' strategy for debt collection is reflected in its Cross-Servicing Implementation Guide, Standard Operating Procedures (SOP), and contracts with PCAs. These documents indicate that when nontax debts are referred to FMS, BDMOC collects debts using tools such as demand letters, phone calls, and payment offset through TOP. Debts were to be referred to PCAs for collection if FMS could not secure an acceptable agreement with the debtor or locate the debtor. To expedite debt collection, the procedures stated that debts may be referred to TOP and will be referred to PCAs within stipulated time frames.

We statistically selected a sample of 200 debts from a population of 61,269 debts with balances greater than \$100 referred to FMS from April 1998 through May 1999. We identified FMS' collection activity for these 200 debts, as well as by PCAs for the debts that were subsequently referred to the PCAs.

Our tests of these 200 selected debts found that FMS collectors¹⁸ did not always adhere to the cross-servicing SOP. For example, we found that FMS collectors

- did not always attempt to contact debtors or perform skiptracing to locate debtors who did not respond to demand letters,
- negotiated two repayment agreements that significantly exceeded authorized pay back time frames, and
- did not always promptly refer all debts to TOP or PCAs.

Contacting Debtors

One of the most critical steps in collecting delinquent debt is communicating with the debtor after the required demand letter is sent. This is necessary because the collector must (1) determine whether the debtor acknowledges the debt is owed, (2) determine the debtor's willingness to fully pay or pay a portion of the debt, and (3) attempt to establish a formal repayment agreement with the debtor.

When the debtor fails to respond within 10 days after the demand letter is sent, collectors were required to contact the debtor by telephone. If a valid telephone number was not available or the demand letter had been returned as undeliverable, the collector was then required to start skiptracing activities to locate the debtor.

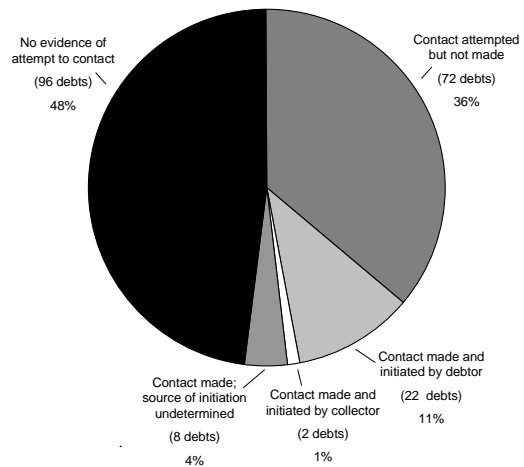
¹⁸FMS collectors* refers to FMS' collectors at BDMOC.

The debt history files indicated that FMS issued demand letters for all 200 debts we statistically selected and reviewed. However, for 168 of these 200 debts, there was no subsequent contact between the debtor and the collector, and, as shown in figure 3, we found no evidence that FMS' collectors subsequently tried to contact 96 (48 percent) of these debtors.¹⁹ For the remaining 72 of the 168 debts, information in the debt history files indicated that FMS collectors had no success in their attempts to contact the debtor by telephone or locate the debtor by other collection activities, such as skiptracing. FMS collectors attempted to phone the debtor for 31 of the 72 debts. However, for certain of these debts, available documentation suggests that these efforts were limited. Specifically, the debt history files showed that for 18 of these 31 debts, the collector placed only one phone call to the debtor with no subsequent follow-up. For the remaining 41 of the 72 debts, FMS collectors performed skiptracing.

¹⁹The population of delinquent debts from which our sample was drawn totaled 61,269 debts. Based on our test results, we estimate that for 29,409 (or about 48 percent) of the delinquent debts, there was no evidence that FMS collectors attempted to telephone or make any other contact with the debtor. We are 95-percent confident that the number of debts with no evidence of telephone or other contact was between 25,727 (or about 42 percent) and 33,116 (or about 54 percent).

Figure 3: Most Debtors Not Contacted by FMS Collectors Subsequent to Issuance of Demand Letter

(Statistical sample of 200 delinquent debts referred to FMS from April 1998 through May 1999)



Source: GAO's analysis of selected FMS debt history files.

In our sample of 200 delinquent debts, the debt history files indicated that demand letters for 46 of the debts were returned as undeliverable. For 29 of these 46 debts, we found no evidence that FMS collectors performed the required skiptracing to locate the debtor.

FMS officials stated that its collectors might not have documented all discussions they had with debtors. However, FMS' procedures required collectors to record all debtor conversations and collection activity in the debt history files. Moreover, the *Comptroller General's Standards for Internal Controls in the Federal Government*²⁰ states that all transactions

²⁰*Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999).

and other significant events need to be clearly documented and that the documentation should be readily available for examination.

FMS officials also stated that its collectors might not have been able to perform all the collection activities for each debt within the stipulated time frames. In particular, according to these officials, FMS' collection efforts were negatively affected when FMS received large batches of referred debts from the Department of Housing and Urban Development (HUD) and the Small Business Administration during our detailed testing period. Our review of referred debts by month for the 14-month testing period showed that, generally, as referrals increased, the percentage of debts in our sample with no evidence of attempts to contact the debtor also increased.

FMS did not establish any written guidance to help its collectors determine which debts to cross-service first during peak referral periods. In addition, FMS did not perform any analysis to determine if it would be more cost effective, especially during peak referral periods, to send all or certain types of debts immediately to the PCAs. For example, FMS did not review its history of debt collections to determine if its collectors have had more success in collecting debts with certain characteristics (e.g., age of delinquency, dollar value of debt, referring agency, commercial versus consumer). During peak referral periods, FMS collectors could then focus on such types of debts while forwarding the rest to the PCAs, thereby avoiding further aging of debts for which no collection efforts are likely to be taken.

Repayment Agreements

When entering into a repayment agreement with debtors who are unable to pay the full debt immediately, collectors were required to adhere to repayment period time limitations. The recommended period for repayment agreements is up to 36 months or the period established by the referring agencies in their Agency Profile Form.²¹

For 13 debts in our sample of 200 that involved repayment agreements, 2 had terms of 75 months and 96 months, significantly exceeding the 36-month preauthorized limit established by the referring agency. We found no evidence in the debt history files that FMS collectors obtained approval to exceed these limits from the referring agency or FMS management.

²¹Agency Profile Forms are used by the referring agency to report its collection parameters, such as maximum repayment periods and limits on compromise and repayment amounts.

According to FMS officials, this lack of evidence was likely due to errors made by FMS collectors.

Compromised Debts

A debt compromise involves the government agreeing to accept less than the full amount of its claim in satisfaction of the entire debt. In accordance with the cross-servicing SOP, a debt may be compromised if there is legitimate doubt about the debtor's ability to pay, the government's ability to collect, or if the cost of collecting exceeds the benefit. If a compromise is accepted and the agreed amounts are paid, the debt is closed and returned to the client agency.

According to FMS' cross-servicing SOP,

- collectors first had to attempt to obtain payment in full before they offered a compromise,
- before offering a compromise, the collector was required to obtain the debtor's Taxpayer Identification Number (TIN) so that the compromised amounts could be reported to IRS,
- collectors were required to obtain current financial statements from the debtor to determine the debtor's ability to pay and assess the merits of a proposed compromise, and
- collectors were authorized to enter into a written compromise repayment agreement not to exceed 3 months.²²

In our statistically selected sample of 78 compromised debts, our analysis showed that the compromised amounts ranged from about \$27 to \$36,000 and averaged \$4,863. The compromised amount as a percentage of outstanding balance averaged 39 percent. During our review of the 78 compromised debt history files, we found that

- 75 (96 percent) files did not indicate why collectors compromised debts or the basis used to determine how these debts met FMS' criteria for compromising,

²²The Federal Claims Collection Standards state that agencies that agree to accept payment in regular installments should obtain a legally enforceable written agreement from the debtor that specifies all the terms of the arrangement and contains a provision for accelerating the debt if the debtor defaults.

- 72 files had no evidence that the collector attempted to obtain a lump sum payment in full or a repayment agreement for the full amount before compromising the debt, and
- 74 files did not have documentation, such as financial statements or any other type of financial analysis, to support the compromise decision.

For example, one debt history file indicated that a debtor was allowed to pay \$62,000 to settle an agency's debt with an outstanding balance of about \$98,000. This agency had authorized FMS to compromise up to 10 percent of the outstanding balance of the debt, but there was no authorization from the agency or other support for compromising about \$36,000, approximately 37 percent, of the outstanding debt. Further, there was no documentation to show that the FMS collector had followed the cross-servicing SOP or had analyzed the debtor's financial condition or ability to pay.

Our review of the 78 compromised debts also found the following.

- Thirty-two debts involved written or oral compromise repayment agreements. Of these 32,
 - 30 agreements exceeded the established 3-month repayment limit. The terms of these agreements ranged up to 13 years, half of which exceeded 3 years, for an average of 57 months.²³ One FMS collector compromised \$7,966, or about 50 percent, of an agency's debt with an outstanding balance of \$15,932 and entered into a compromise repayment agreement in which the debtor is being allowed to pay \$50 per month for 159 months.
 - the debt history files for 19 debts did not contain (1) a signed written compromise repayment agreement and (2) evidence that the FMS collector attempted to follow up to obtain a signed written agreement from the debtor.
 - the debtors defaulted on 16 of the 32 agreements. Of these 16 debts, 7 had no evidence in the debt history files that the FMS collector

²³Under the revised procedures, collectors may offer compromise repayment agreements for up to 12 months.

contacted the debtor to determine whether the debt collection strategy could be modified.

- Four of the 16 debts with defaulted compromise repayment agreements were not requested for referral to PCAs until more than 30 days after default.
- Eleven of the 78 debts did not have a TIN listed in the debt history files or any evidence that the FMS collector attempted to obtain a TIN required for IRS reporting and needed for referral to TOP.

TOP Referrals

When routine debt collection techniques fail, the cross-servicing SOP requires FMS collectors to pursue the debtor with more aggressive approaches, such as using TOP. According to FMS' cross-servicing SOP, debts may be referred to TOP for offset 20 days after the date of the demand letter. FMS' debt management system notifies collectors when the 20 days has expired.

We found that FMS' collectors referred 13 of the 62 debts that were eligible for referral to TOP within the stipulated time frames. On the other hand, FMS did not refer 36 of the 62 debts that were eligible for referral to TOP promptly at 20 days because of interface problems between internal computer systems. In addition, FMS collectors referred another 7 debts to TOP between 5 and 141 days after the 20-day period and had not referred 6 other debts as of the completion of our detailed testing. According to FMS officials, the late referrals or lack of referrals for the latter 13 debts were likely due to errors made by FMS collectors.

Referral to PCAs

FMS' cross-servicing SOP required FMS collectors to request debts that are not in an active repayment status, paid in full or compromised, or referred to the Department of Justice for litigation to be referred to a PCA. FMS collectors were to request eligible debts be sent to the PCAs at 30 days after the date of the demand letter (before January 1999, the standard was 50 days).

We found that FMS' collectors did not promptly request referral of many debts to PCAs. In our sample of 200 delinquent debts, 183 debts were eligible for referral to PCAs at the time of our detailed testing. For 33

(about 18 percent) of the 183 debts eligible for referral to PCAs,²⁴ FMS collectors requested referral of these debts to PCAs between 3 and 383 days, or an average of 62 days, after the 30-day (or 50-day) time period.

We also identified instances where there were significant delays between the date the FMS collector requested a debt referral to a PCA and the date FMS actually transferred the debt to a PCA. Of the selected 183 debts eligible for referral, 178 had been referred to PCAs as of the date of our detailed testing. Nineteen of these 178 debts were transferred from FMS to the PCAs between 30 and 64 days after the FMS collectors' request. As a result, no collection activities were taking place and these debts continued to increase in age of delinquency. FMS officials could not provide an explanation for the longer time frame.

PCA Collection Activities

For the 178 debts in our sample that were referred to the PCAs, we found that several PCAs did not perform or document certain debt collection procedures required by FMS' contract.

PCAs, among other things, are required by their contract with FMS to send demand letters within 5 working days of receipt of the debt from FMS, attempt to locate debtors through skiptracing, including obtaining credit bureau reports for debtors with debt balances of \$500 or more, and attempt to obtain full payment before compromising any debt. In addition, PCAs are required by contract to record all collection activity occurring on debts in their respective debt collection systems. PCA contract monitors employed by FMS have access to the PCA debt collection systems and are required to regularly review debt records in these systems to verify that demand letters are issued, ensure that collection activity is appropriate, and evaluate payment schedules.

PCAs sent demand letters for 158 of the 178 debts (or about 90 percent) on time. For 17 debts, PCAs sent letters between 1 and 87 days late, averaging 15 days late. As of the date of completion of our detailed testing, no demand letters had been sent for 3 of these selected debts. According to FMS officials, delays in sending 13 of the 17 late demand letters were primarily caused by one PCA that did not download its electronic debt files in a timely manner.

²⁴The population of delinquent debts from which our sample was drawn totaled 61,269 debts. Based on our test results, we estimate that FMS collectors did not promptly request referral to a PCA for 10,109 (about 16 percent) debts of this population. We are 95-percent confident that the number of debts lacking prompt referrals was between 7,554 (about 12 percent) and about 13,136 (about 21 percent) of the population.

In addition, PCAs did not always obtain credit bureau reports as part of skiptracing. Of the 178 debts referred to PCAs, 152 debts had balances over \$500, and their debt history files indicated that the collector performed or should have performed skiptracing. For 19 of these 152 debts, we did not find evidence in the PCAs' debt collection systems that the collector obtained the required credit bureau report. When we brought this to the attention of FMS officials, they immediately acted by issuing a technical bulletin to PCAs to remind them of the contractual requirement to obtain credit bureau reports as part of skiptracing activity for debts with balances of \$500 or more.²⁵

Of the 178 delinquent debts referred to PCAs, we identified 10 debts that involved compromise offers by PCAs. For 4 of these 10 debts, the PCA's debt collection system had no indication that the PCA attempted to obtain either a lump sum payment in full or a repayment agreement for the entire amount before compromise. Further, for all 10 debts, the PCA's debt collection system did not indicate that the collector requested financial statements or other documents reflecting the debtor's financial condition or ability to pay, and such documents, if they existed, were not provided to us by FMS.

Revised SOP

In February 2000, after we completed our detailed testing of FMS' collection activities and briefed FMS on the results of such testing, FMS revised its cross-servicing SOP. The new procedures allow FMS collectors discretion over which debt collection procedures they choose to perform by changing many of the SOP requirements that used to be designated as "will" be performed to "may" or "should" be performed. FMS officials have also emphasized to us that FMS will rely heavily on PCAs to collect referred debt under the revised procedures. However, under the revised SOP, FMS' collectors may continue to hold and cross-service debts for 30 days before referring them to PCAs.

Based on these actions and discussions with FMS officials, FMS is placing increased reliance on PCAs. However, FMS has not performed an analysis to determine the potential effect such reliance may have on net collections to the federal government. Such an analysis may be warranted given that (1) as the debts are not actively worked by BDMOC and are awaiting referral to PCAs, they continue to age and thus typically become more difficult to collect and (2) the federal government pays a 25-percent fee on

²⁵Technical Bulletin-Number 18 (Revised) August 30, 1999.

debt amounts collected by the PCA that the government is not always able to recoup from the debtor.

Distribution of Debts to PCAs

You were interested in how debts were distributed to PCAs. In the fall of 1996, FMS began development of the PCA Monitoring and Control (PMAC) system to distribute debt accounts to PCAs, track PCA collection performance, and monitor PCA collection activities. For the first distributions made to PCAs from February through June 1998, each PCA received an equal percentage of the total dollar amount of debt accounts from each distribution. After this first performance period, FMS assessed the performance of the PCAs every 4 months thereafter to determine the dollar percentage of a distribution that each PCA would receive typically on a biweekly basis. FMS then adopted a systematic process, described below, to distribute the debts to the PCAs.

In preparing for these subsequent distributions to the PCAs, the debts were first arrayed by the earliest to the latest date the electronic data were entered into the PMAC system and then, for each date entered, by dollar amount from highest to lowest. The PCAs were then arrayed starting with the PCA with the highest distribution goal amount,²⁶ followed by the remaining PCAs in descending order. The system then began sequentially assigning the debts to the PCAs until each PCA had received at least one debt. After the first round, the system reordered the PCAs from the largest remaining goal amount to the smallest. The PMAC system continued to sequentially assign debts and reorder the PCAs after each debt was assigned until all eligible debts had been distributed. A more detailed description of this process is included in appendix II.

We obtained copies of pertinent data from the PMAC system and performed various analyses of the debt account information, including distribution of the debt accounts to the PCAs, age of delinquencies, and collection rates. Our analysis of FMS' distribution of debt accounts from the inception of the program (February 1998) through February 2000, which is partially summarized in table 2, showed that one PCA had received a significantly higher percentage of the debts with smaller balances. Overall, the average balances of the debts distributed to this particular PCA were 45 percent lower than the average balances of all debts distributed during this time frame. Specifically, debts distributed to

²⁶Every four months, FMS evaluated PCAs' performance based on several performance indicators. These results were then used to determine each PCAs percentage of debts to be received for each distribution during the next performance period. The PCA with the top performance was to receive the largest dollar amount of debts.

this PCA had average balances of \$11,436, while the overall average balances of debt accounts distributed to PCAs were \$20,845.

Table 2: Analysis of Debt Distributions

PCA	Number of debts distributed as a percent of total debts distributed	Dollar amount of debts distributed as a percent of total dollars distributed	Average debt balance
1	4%	6%	\$31,034
2	6%	10%	\$31,944
3	6%	6%	\$23,041
4	29%	16%	\$11,436
5	8%	8%	\$22,275
6	7%	9%	\$29,620
7	9%	9%	\$19,722
8	11%	13%	\$24,922
9	7%	7%	\$18,603
10	7%	9%	\$25,025
11	6%	7%	\$26,217
	100%	100%	\$20,845

Source: GAO's analysis of the PMAC database for debts distributed to PCAs from February 1998 through February 2000.

This trend also existed for many of the age of delinquency categories: less than 180 days, 180 days to 1 year, 1 to 2 years, 2 to 4 years, 4 to 6 years, 6 to 11 years, and greater than 11 years. We found that in the first four delinquency categories noted above, the PCA mentioned above had the smallest average debt balances. This PCA also had the next to the smallest average debt balances in the 4 to 6 years and 6 to 11 years delinquency categories. For example, we found that 27 percent of this PCA's debts were less than 1 year delinquent, with an average balance of \$5,593. In addition, we found that 32 percent of the total number of debts that were less than 1 year delinquent were distributed to the one PCA. These debts also represented 19 percent of the total dollars of debt in this delinquency category. The PCA to receive the next highest percentage of the debts less than 1 year delinquent was distributed 11 percent of the total number of debts representing 13 percent of the total dollars, with an average debt balance of \$10,694.

On the other hand, we found that for one agency's debts for which no collections had been made through February 2000, 35 percent of the total number of accounts for this same agency were distributed to two PCAs, representing 55 percent of the total amounts received by these PCAs, with a combined average balance of \$2.7 million. The one PCA mentioned above, who is not one of these two, received 17 percent of the total

number of accounts of this same agency's debts representing 14 percent of the total amounts received by the PCA with an average balance of \$1.4 million. We noted that several agencies had referred debts with large average dollar balances ranging from \$54,000 to \$1.7 million for which no amounts have been collected.

Further, we analyzed collections on closed debt accounts with payments categorized by age of delinquency. Collection industry statistics have shown that collection rates are generally higher on debts with smaller dollar balances and that are less delinquent. While the PCA mentioned above had collected the most in total dollars, it ranked highest in collections as a percentage of the total amounts referred only in the 1 to 2 years and 4 to 6 years delinquency categories. In the other five delinquency categories, other PCAs had higher collection percentages. Our analysis also showed that generally three out of the four PCAs with the highest collection percentages in each delinquency category had average debt balances that were below the overall average balances for that category. For example, the three PCAs with the highest collection percentages in the less than 180 days delinquent category had average account balances of \$265, \$810, and \$857. The overall average account balances for this delinquency category was \$2,003. Thus, FMS' collection experience appears to be consistent with that of the collection industry statistics noted above.

Concerns relating to the distribution method have been raised by some of the PCAs. During our interviews with the 11 PCAs, we found that when asked how the debts should be distributed, the general consensus among them was that the distribution should consider the characteristics of the debts, such as age of delinquency, type of debt (consumer or commercial), agency referring the debt, and debt balance. Many of the PCAs indicated that stratifying the available debts by agreed-upon characteristics would result in each of the PCAs receiving a proportionate mix of the debts and foster a more competitive environment.

An important consideration to help ensure that each PCA receives a proportionate mix of debts is that the population of debts to be distributed is homogeneous, i.e., of the same characteristic, such as age of delinquency, balance, type, or originating agency. For each distribution, FMS placed all the debts available into one pool. Our analysis of the debts found that the debts within each distribution's pool were generally not of the same composition, i.e., not of the same average balance or age of delinquency. This factor contributed to the distribution results experienced by FMS which are discussed above.

FMS compiled information on the distribution and collection of the debts referred to the PCAs in response to various congressional and other requests. During our fieldwork, FMS had not yet analyzed these data. Given the above noted PCAs' feelings about the distribution method and the results thus far of FMS' distributions to the PCAs, it may be necessary for FMS to periodically analyze the distribution and collection data to determine whether adjustment is needed to the distribution model to assure that a proportionate mix of debts is being distributed to the PCAs and competition among the PCAs is more fully promoted.

FMS' Cross-Servicing Fees and Related Costs of Operations

For its services, FMS collects cross-servicing fees from referring agencies that range from 1 percent to 18 percent of the referred debt amounts collected (see appendix III for the details regarding the fees collected). As stated in the SOP, effective during the period of our detailed testing, and as allowed by DCIA, FMS intended for the fees charged for its cross-servicing debt collection activities to fully cover the cost of its related operations. However, for fiscal year 1999, cross-servicing fees totaled \$1.6 million, or about 15 percent, of FMS' \$11 million of estimated cross-servicing costs.²⁷

FMS hired a contractor to assist with the development of its estimated costs, a model for conducting break-even analyses, and fee setting. The FMS contractor indicated that fees for cross-servicing would have to increase substantially over current levels for FMS to achieve full cost recovery.

We determined, using the current fee structure and the fiscal year 1999 collection experience, that FMS would have to increase annual collections by over sevenfold, or collect approximately \$173.5 million, to cover its fiscal year 1999 estimated costs of \$11.0 million. The estimated \$173.5 million in collections would include approximately \$141.6 million to be returned to the referring agency for collected debts, \$20.9 million in fees paid to PCAs, and \$11 million in cross-servicing fees paid to FMS.²⁸

²⁷FMS' estimated costs do not include any agency costs, such as costs incurred by the agencies to refer debts to FMS for cross-servicing.

²⁸Our analysis assumes that no additional costs will be incurred to increase the collection amount. Also, we assumed that all DOJ collections are from post judgment debts where the 18-percent fee would apply on the initial amount. During fiscal year 1999, most of DOJ collections were from post judgment debts.

The amount of collections needed to reach a break-even basis varies substantially depending on who collects the debt, FMS or the PCAs. If FMS did all the collections at its 18 percent rate, debt collections of about \$72 million would be needed to cover the \$11 million estimated costs. Conversely, if FMS relied on the PCAs exclusively for collections, its 3 percent fee on these collections would require that the PCAs bring in collections of about \$471 million to cover these costs.

Projected higher future costs will require even more collections to break even. FMS' fiscal year 2000 cross-servicing cost estimate that we were provided is about \$12.9 million or about 17 percent greater than the fiscal year 1999 estimate. According to FMS officials, FMS has not projected cross-servicing fee revenues and costs beyond fiscal year 2000. Although the officials stated that FMS is currently considering increasing cross-servicing fees, they have acknowledged that the cross-servicing program will not be fully reimbursable in the foreseeable future. Thus, the cross-servicing program will likely have to be funded primarily through appropriations at least in the near term.

In summary, for FMS' cross-servicing program to become a fully implemented and mature program, many challenges lie ahead that must be overcome to assure success in the collection of delinquent debt. These challenges are magnified since as delinquent debt ages further, the likelihood of collection diminishes.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions you or other Members of the Subcommittee may have.

Contacts and Acknowledgments

For information about this testimony, please contact Gary T. Engel at (202) 512-3406. Major contributors to this testimony include Kenneth R. Rugar, Paula M. Rascona, Matthew F. Valenta, Michael S. LaForge, Gladys Toro, and Sophia Harrison.

Appendix I

Explanation of Terms/Data in Table 1

Cross-servicing waivers—Treasury granted the Departments of Education and Health and Human Services waivers from cross-servicing for certain classes of their own debts. According to FMS officials, the waiver, which is valid for a 3-year period, allows the agencies to perform collection activity on those debts subject to the waivers. As of October 1999, agencies can no longer apply for waivers, but rather must apply for exemption from cross-servicing for specific classes of debts.

Debts in forbearance or in appeals—Debts that are subject to forbearance or that are in appeals generally are not “legally enforceable.” Forbearance action taken by a creditor generally extends the time for payment of a debt or postpones, for a time, the enforcement of legal action on the debt. The government cannot pursue collection against a debtor if the debt is not legally enforceable.

At DOJ—Debts that are referred to DOJ for litigation or collection are excluded for referral to Treasury for cross-servicing by DCIA.

Foreign debt—Debt that is owed by foreign governments is excluded for referral to Treasury. Treasury stated that, for the most part, collecting these delinquent debts is infeasible primarily due to foreign diplomacy considerations and affairs of state.

Debts in bankruptcy—The automatic stay mandated by 11 U.S.C. Section 362 generally prevents the government from pursuing collection action against debtors in bankruptcy.

Debts in foreclosure—Debts in foreclosure are governed by state laws. In some states, to maintain the right to foreclose, a creditor must foreclose the collateral securing the debt before seeking other collection remedies. DCIA excludes debts that are in foreclosure for referral to Treasury for collection action.

Department of Defense—According to an FMS official, certain contractor debt held by the Department of Defense (DOD) and reported as debt over 180 days delinquent as of September 30, 1998, was subsequently reclassified from eligible to ineligible debt. Specifically, in August 1999 FMS and DOD agreed to reclassify \$1.3 billion of such debt to ineligible debt due to ongoing litigation.

Debts eligible for internal offset—Debts that will be collected under agency-initiated offset, if such offset is sufficient to collect the claim within 3 years after the date the debt or claim is first delinquent, are excluded for referral for cross-servicing by DCIA.

Appendix I
Explanation of Terms/Data in Table 1

Debts at third party—Debts being serviced and/or collected in accordance with applicable statutes and/or regulations by third parties, such as private lenders or guaranty agencies, are exempt from cross-servicing by Treasury regulations.

Appendix II

FMS Distribution Methodology

The PMAC system begins the distribution process by creating a list of debt accounts for distribution that are ordered first by the earliest to latest date the debt account was entered into the PMAC system. Then, for each date entered, by dollar amount from highest to lowest. The PMAC system then performs a series of calculations to determine a dollar-limiting amount that represents the highest dollar amount of an individual debt account included in the distribution list. All individual debts that exceed the dollar-limiting amount are excluded from that distribution. According to FMS officials and its contractor, the dollar-limiting amount was established to help ensure that no debt accounts would be assigned that are larger than every PCA's distribution goal amount. According to FMS, the list of debt accounts are ordered by date entered into the PMAC system to help ensure that no debt account will remain unassigned for an extended period of time.

Next, the PMAC system calculates the goal distribution percentages for each PCA. The goal distribution percentages are based on the performance evaluation results of the prior 4 month performance period and are used to determine the dollar amount of debts each PCA will be allocated. The PMAC system then orders the PCAs by listing the PCA with the largest distribution goal first followed by the remaining PCAs in descending order according to goal distribution amounts. The PMAC system assigns the debt accounts sequentially from the debt account listing to PCAs so that the PCA with the largest remaining distribution goal amount will receive the debt with the largest balance and so forth. A debt can be assigned to a PCA if the debt amount will not cause the PCA to exceed its remaining distribution goal amount within a preestablished tolerance amount and the debt account has not been previously assigned to the PCA in a prior distribution. If the debt account cannot be assigned to the first PCA on the list, the system proceeds to the next PCA. This process continues until each PCA has been assigned at least one debt account.

After each PCA has been assigned at least one debt account, the PCAs are reordered from the largest remaining distribution goal amount to the least. The PMAC system continues to sequentially assign the debt accounts and reorder the PCAs after each debt account is assigned until all eligible debts that can be assigned have been assigned. Debt accounts that are not assigned during the distribution process are included with the next distribution.

Appendix III

FMS' Cross-Servicing Fee Rates

In its standard written agreement with all referring agencies, FMS requires agencies to pay FMS cross-servicing fees for nontax debt collections on debts referred to FMS. The agreement states that FMS is entitled to a cross-servicing fee for all nontax debt collections received after it initiates collection action, which is defined as the issuance of a demand letter and/or an attempt to contact the debtor. FMS fees are based on a percentage of the initial referred debt amount that is collected. FMS' cross-servicing fees effective during the period of our fieldwork are listed below in table 3.

Table 3: Cross-Servicing Fee Rates

Type of cross-servicing collection	Fee rates (%)
Debts referred to FMS for cross-servicing and collected by FMS collectors	18
Post-judgement debts referred to FMS and subsequently collected by the Department of Justice (DOJ)	18
Debts referred to FMS for cross-servicing and subsequently collected by PCAs	3
Debts referred to FMS for cross-servicing and subsequently collected by TOP	3
Debts referred to FMS for cross-servicing and subsequently collected by DOJ (excluding post-judgement enforcement)	3
Debts referred to FMS and sent directly to and collected by PCAs with no collection activity performed by FMS, referred to as "pass-throughs"	1

(901803)

Comments From the Financial Management Service



DEPARTMENT OF THE TREASURY
FINANCIAL MANAGEMENT SERVICE
WASHINGTON, D.C. 20227

July 12, 2000

Mr. Jeffrey C. Steinhoff
Assistant Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Steinhoff,

The Financial Management Service (FMS) has received for comment a copy of the recent draft audit report (GAO/AIMD-00-234), entitled Debt Collection: Treasury Faces Challenges in Implementing Its Cross-Servicing Initiative. This letter transmits FMS' response to that report.

Recommendations

1. *Work with the Office of Management and Budget and the agencies' Offices of the Inspector General to develop and implement a process for obtaining periodic independent verification of the accuracy, completeness, and validity of debts reported by agencies as eligible and excluded from the DCIA cross-servicing provisions.*

We concur, with comment. FMS does not have authority to issue audit guidance; the Office of Management and Budget does. We do require that agencies certify the accuracy of reported debts, and we work closely with agencies, both directly and through the Federal Credit Policy Working Group, to ensure accuracy. We will work with the Office of Management and Budget and agency Offices of Inspector General as needed to help verify accuracy, completeness, and validity of eligible and excluded debts.

2. *Revise FMS' reporting of debt amounts referred for cross-servicing to reflect the extent to which eligible debts reported by agencies as of a specific date have been referred to FMS.*

We concur, with comment. We agree that debts eligible for referral as of a given date should be compared with debts actually referred as of that date. We are in the process of revising the Treasury Report on Receivables (TROR) to give agencies the opportunity to indicate how much of the debt they indicate is eligible to be referred actually has been referred. This will be a point in time at the end of the fiscal year. In addition, FMS will need to track and monitor agency performance in referring debt after the September 30 date and throughout the following fiscal year.

See comment 1.

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3. Establish and implement procedures for obtaining, reviewing, and monitoring written debt referral plans from CFO Act agencies and all non-CFO Act agencies with significant accounts receivable activity, to help ensure that (1) the plans are complete, agree with debt amounts agencies have reported as eligible for cross-servicing, and specify timetables for referral of all such debt, (2) actual agency referrals are compared with agency plans and explanations for any significant deviations from planned referrals or revisions to the plans are obtained from the agencies, and (3) appropriate agency officials are notified and requested to initiate corrective actions when agencies do not substantially comply with their referral plans.

We concur. Procedures are in place and operating. FMS is currently in the process of formally documenting those procedures.

Perform a comprehensive review of FMS' cross-servicing process to determine whether FMS' current debt collection strategy and standard operating procedures are appropriate for optimizing collections by...

4. ... analyzing the types of debts referred to FMS (e.g., by age of delinquency, debt balance, etc.) and the collection rates experienced on those debts.

We concur, with comment. Analyzing collection rates is only one factor in assessing FMS' success. FMS assists agencies by clearing debts that never should have been referred.

5. ...assessing the level of effort FMS collectors should perform by considering the number of collectors assigned, the number and types of debts individual FMS collectors can be expected to effectively cross-serve, and fluctuations in the volume of debts referred by agencies and the related impact, if any, on FMS collector workloads.

We do not concur. Such an assessment would be impractical. Because debts are referred sporadically and randomly, there is no way to usefully identify the number and types of debts individual FMS collectors can be expected to effectively cross-serve (for example, SBA referred more than 10,000 debts to FMS in April and May of 1998; in FY 2000, SBA has averaged a little more than 500 debts per month). We believe our procedure for working a debt is appropriate: the Birmingham Debt Management Operations Center (BDMOC) services delinquent debt for the first 30 days after it has been referred to Treasury for cross-servicing. During this time, it sends a demand letter, attempts to contact the debtor by telephone (as workload volume allows), and, if it has received no response after 20 days, refers the debt to TOP for offset. If, after 30 days, BDMOC has been unable to obtain payment from the debtor and/or establish a repayment agreement, the debt is promptly referred to a private collection agency, which then becomes responsible for collecting the debt and will send a demand letter, enter into a repayment agreement, or compromise with the debtor. This process greatly enhances our overall collection efforts due to the response generated by the Treasury demand letter and the efforts of the BDMOC debt collectors. In addition, BDMOC is a designated Debt Collection Center, and is functioning in accordance with the DCIA's goal of consolidating and improving government-wide debt collection. Thirty days is a reasonable time frame to allow debtors to

See comment 2.

See comment 3.

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respond and for FMS to work the debt, including attempting to clear up debts that are not valid, before referring them to the PCAs.

In addition, FMS has consistently adhered to the principle, espoused in the legislative history of the Debt Collection Improvement Act of 1996 and by Congress in its subsequent deliberations on our debt collection programs, that we should make full and appropriate use of the private sector. FMS does not believe it should attempt to replicate, or compete with, private collection agencies. Rather, its role is to ensure that debts are properly managed throughout the collection process and that all available and eligible debt collection tools are utilized. Given that debts are referred sporadically, it would be prohibitively costly for FMS to temporarily staff up as a result of an agency referring all of its old debt at one time; this is why FMS relies on the PCAs: they have a greater ability to react to fluctuating volumes.

6. ...making revisions, if any, to the standard operating procedures based on the assessment of the level of collection efforts FMS collectors should perform while maintaining appropriate internal controls and accountability over FMS collection efforts.

See comment 4.

We concur. Revisions to standard operating procedures have been effected.

7. ...identifying specific types of debts, if any, that should be sent promptly to the PCAs for cross-servicing and determine the appropriate level of involvement by FMS collectors on such debts.

See comment 5.

We do not concur. Please see the response to Recommendation 5 above. We believe our current process is appropriate. Most of FMS' issues with workload have occurred when new agencies begin cross-servicing and refer thousands of their old debts to FMS at one time. It is impossible to staff up for these large numbers of referrals, particularly when FMS receives minimal lead time. FMS' ability to analyze workloads will continually improve as agencies continue to refer debts on a regular basis.

8. ...enforcing compliance with established collection procedures performed by FMS collectors and take appropriate corrective actions when deviations from established procedures are found.

See comment 6.

We concur. The Debt Management Servicing Center (DMSC) Collection System assigns a work list to each collector. Management reviews the work list and the debts listed, and reviews and approves each action taken. Through day-to-day monitoring of collectors' activities, management assesses the collector's performance and corrects deviations from established procedures.

9. ... enforcing compliance with established procedures for FMS staff to monitor PCAs' collection activities and take appropriate corrective actions when PCAs deviate from established requirements.

See comment 7.

We concur. FMS has dedicated monitors that have on-line access to each private collection contractor's system. The monitors can see at any given time what is happening to individual

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accounts and can check the PCAs compliance with Treasury's contract. Additionally, the COTR conducts on-site annual and ad hoc compliance reviews on each private collection contractor checking for compliance to State and Federal laws, physical and personnel security, resolution of complaints and system requirements.

10. ... periodically analyzing FMS' cross-servicing costs and related fee structure.

We concur. Cross-servicing costs and fee structures are reviewed annually.

11. Work with the PCAs to determine what characteristics of the debts—age of delinquency, type of debt (consumer or commercial) agency referring the debt, or debt balance—should be considered when distributing debts to PCAs for collection.

We concur. FMS has already started work on this. A PCA conference was held on June 12 and 13, 2000. FMS solicited comment from the PCAs on what changes they would like to see for the new debt collection contract, including how debts are distributed, and has shared the feedback with all of the PCAs from that conference. As a result, and as part of the new contract effort, FMS is reviewing that feedback to determine what new system requirements will need to be developed.

12. Establish and implement a process to periodically analyze the distribution and collection data to determine whether adjustment is needed to the distribution model.

We concur, with comment. Adjustments are made with each new debt collection contract. Instituting changes in the middle of a contract period is not feasible due to systems and legal issues.

Other Comments

While we are otherwise in general agreement with the draft report from a technical standpoint, we offer three substantive comments in the interest of accuracy and clarity:

(1) Page 2, last paragraph, states that: "...[FMS] staff and some PCAs did not always follow established procedures and requirements or effectively use certain debt collection tools. For example, we found no evidence that FMS' collectors had tried to contact about 48% of the debtors from our sample after the demand letters were issued."

Our policy is to do what we can in the first 30 days, even though our procedure did not clearly state that and has since been revised. We would not have expected the collectors to have necessarily made contact with the debtors. The main purpose of the first 30 days is to issue demand letters and give the debtors an opportunity to call us and arrange to pay off their debts or set up repayment agreements. We use other methods of collection during the 30-day period only when volumes are small enough to allow us to do so.

See comment 8.

See comment 9.

See comment 10.

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(2) Page 3, middle paragraph, states that: *"in 1999, FMS changed its SOP to reduce the 50-day holding period to 30 days for performing cross-servicing procedures before referring the debts to a PCA."*

See comment 11.

FMS changed its SOP in 1998 to reduce the 50-day holding period to 30 days.

(3) Page 3, middle paragraph, also states that: *"(1) as debts are not actively worked by FMS and are awaiting referral to PCAs, they continue to age and thus typically become more difficult to collect..."*

See comment 12.

FMS does actively work all debts (see responses to Recommendations 5 and 7 above). Issuing demand letters and giving debtors an opportunity to respond within 30 days is a reasonable and positive step prior to sending debts to PCAs.

(4) Page 3, middle paragraph goes on to say that: *"... (2) the federal government pays a 25 percent fee on debt amounts collected by the PCA that the government is not always able to recoup from the debtor."*

See comment 13.

This is true only if the debtor compromises the debt. This is reasonable, as many of the debts are more than four years old and were not worked prior to referral to cross-servicing. If the debt is paid in full, the debtor is paying the PCA fee, with the exception of a small number of cases referred by USDA/FNS. Because many debts are over four years old, the compromises agreed to by the PCAs do bring in money that may never have been received prior to the Debt Collection Improvement Act. And because PCA compromises are mostly one-time payments, debts are being resolved rather than remaining on the books. As agencies start sending more current debts, the need for compromises should diminish. Centralizing debt collection through FMS involves more than the active collection activities of sending demand letters, making phone calls, and skiptracing. FMS is responsible for managing debts throughout the debt collection process, even when other debt collection tools are being utilized simultaneously (Treasury Offset Program and PCAs). FMS also manages the relationships between the 150 bureaus and agencies, the 11 PCAs, and the debtors. As the cross-servicing program continues to mature and agencies are making regular referrals to FMS, FMS will continue to review the cross-servicing process and make changes where appropriate.

Thank you for the opportunity to respond to this draft GAO report. If you have any questions or wish to discuss these comments further, I can be reached at (202) 874-7000.

Sincerely,



Richard L. Gregg

cc: Don Hammond, OFAS

The following are GAO's comments on the Financial Management Service's letter dated July 12, 2000.

GAO's Comments

1. As we reported, no formal process currently exists for independent verification and reporting on the accuracy, completeness, and validity of debts reported by agencies as eligible and excluded from the DCIA cross-servicing provisions. As stated in our report, FMS stated that as of September 30, 1999, about \$52.8 billion or approximately 89 percent of the \$59.2 billion of debt over 180 days delinquent was excluded from cross-servicing. Because of the magnitude of the amounts reported as excluded, FMS needs to develop a definitive plan to obtain independent verification of this information. The intent of our recommendation was not for FMS to help verify the accuracy of these reported amounts on an as-needed basis. Rather, our intent was that FMS, as the sole governmentwide debt collection center, would lead and coordinate efforts among FMS, OMB, and each of the respective agency OIGs in the development and implementation of a formal process for obtaining independent verifications of agency reported amounts.
2. Assisting agencies by clearing debts that never should have been referred has been one aspect of FMS' many functions. However, our intention was that our recommendation would be read in a broader context and that analyzing the eligible debts referred and the associated collections on those debts is just one of the steps that should be performed when conducting a comprehensive review of FMS' cross-servicing process and strategy to determine what types of debts and the level and mix of debt collection efforts that should be performed by the FMS collectors. See our discussion in the "Agency Comments and Our Evaluation" section.
3. FMS' discussion of its process in its comments reflects the procedures called for by its revised SOP. However, one of the reasons that we recommended that FMS perform a comprehensive review of its cross-servicing processes was that our testing found that FMS staff did not always follow the FMS SOP before it was revised or properly use certain debt collection tools. As we stated in our report, we found that the written SOP at the time of our testing was well developed. For example, the SOP required that "the collector will try to reach the debtor by telephone, if there was no initial response from the demand letter." However, during the course of our work and as stated in our report, FMS revised many of its SOP requirements to perform various

collection techniques from “will” be performed to “may” or “should” be performed. Our recommendation that a comprehensive review of FMS’ cross-servicing process be conducted was made out of concern that FMS has not fully evaluated the impact that such changes to the SOP could have on the level and type of collection efforts performed by FMS collectors and the ability of FMS management to maintain proper accountability and controls over FMS collector activities under the revised SOP.

Similarly, an FMS collector waiting for debtors to respond to a demand letter does not indicate that the debt is being actively worked and is not an effective debt collection technique. As stated in our report, our tests of the sample of 200 delinquent debts found that only 22 of the debt history files indicated that the debtors initiated contact with FMS. Further, in our sample of 200 delinquent debts, the debt history files indicated that demand letters for 46 or about 23 percent of the delinquent debts tested were returned as undeliverable. As we stated in our report, one of the most critical steps in collecting delinquent debt is communicating with the debtor after the required demand letter is sent. Our recommendation that a comprehensive review of FMS’ cross-servicing process be conducted was based in part on the results of our testing, which found that FMS collectors did not always attempt to contact debtors or perform skiptracing to locate debtors who did not respond to demand letters.

FMS should make full and appropriate use of the PCAs. Our recommendation does not contemplate the duplication of PCA collection activities or competition with the PCAs. Rather our point was that FMS perform a comprehensive review of its cross-servicing processes and strategy to make informed decisions about the most effective and efficient way to collect the delinquent debts. With the results of such a review, FMS will be in a position to (1) quantify the number and type of debts for which FMS could reasonably perform collection activities, (2) determine the types of procedures that should be performed, and (3) establish reasonable time frames for FMS collectors to perform the collection activities. See our discussion in the “Agency Comments and Our Evaluation” section.

4. See comment 3 and our discussion in the “Agency Comments and Our Evaluation” section.

5. See our discussion in the “Agency Comments and Our Evaluation” section.
6. During the course of our work, FMS did not provide us with any evidence that management had identified any of the same types of problems with FMS collector activities as were identified in our report. One of the objectives of our recommendation that management perform a comprehensive review of the cross-servicing process was for FMS management to determine whether there are instances of noncompliance with established policies and procedures and, if so, that it make needed changes to strengthen controls over FMS collector activities. See comment 3 and our discussion in the “Agency Comments and Our Evaluation” section.
7. During the course of our work, FMS did not provide us with any evidence that management had identified any of the same types of problems with PCA collection activities as were identified in our report. For example, only when we notified FMS that certain PCAs were not obtaining credit bureau reports for debts with balances over \$500 as part of required skiptracing did FMS issue a technical bulletin to PCAs reminding them of this contractual requirement. One of the objectives of our recommendation that management perform a comprehensive review of the cross-servicing process was for FMS management to determine whether there are instances of noncompliance with established policies and procedures and, if so, that it make needed changes to strengthen controls over PCA collector activities. See comment 3 and our discussion in the “Agency Comments and Our Evaluation” section.
8. Although FMS states that it reviews cross-servicing costs and fee structures annually, the intention of our recommendation was that FMS should analyze its costs and related fee structure in conjunction with its overall assessment of FMS’ debt collection strategy. As stated in our report, our analysis of FMS cross-servicing fees and related operating costs found that collection volume would need to rise more than sevenfold above its fiscal year 1999 collections to put FMS cross-servicing operations on a full cost-recovery basis. In conducting this assessment, FMS should consider the costs of its operations and the revenues collected and make any necessary adjustments to help ensure that its collection efforts are providing the optimal return to the federal government. See our discussion in the “Agency Comments and Our Evaluation” section.

9. The establishment and implementation now of a periodic process to analyze the distribution and collection data should help to place FMS in a position to introduce the kinds of changes needed to address the issues identified by our analysis of the FMS distribution model. These analyses may help FMS management identify changes needed in the distribution model to further competition among the PCAs. These analyses should also provide FMS management with useful information to make more informed decisions on the amount of flexibility that will be needed in its future contracts and systems to institute distribution model changes as the need arises. To the extent that the analyses identify systems and legal issues, FMS should take whatever steps necessary to address those issues.
10. The information in our report about the results of our testing is correct as written. See our comment 3 and our discussion in the “Agency Comments and Our Evaluation” section.
11. We have revised our report to clarify that the written SOP was changed in 1999.
12. The information about the results of our testing in our report is correct as written. See comment 3 and our discussion in the “Agency Comments and Our Evaluation” section.
13. The information in our report regarding the fees that the federal government pays to PCAs for collection services and its ability to recoup such fees is correct as written. As FMS stated, if the debtor pays the full amount of the debt recorded in FMS’ systems which includes any related fees, the debtor is paying the PCA fee. However, FMS has not provided us with any evidence or analysis showing that the government’s inability to recoup the 25 percent fee is limited to those situations that involve compromise agreements. In any scenario where a collection fee is paid, failure by the debtor to pay the entire amount due results in the federal proceeds being reduced by the associated collection fees.

We recognize that a centralized debt collection operation also involves certain management activities that are performed in addition to its collection activities. Therefore, it is even more important that FMS perform a comprehensive review of its operation so that its processes optimize collections in a more efficient and cost-effective manner. See

**Appendix III
Comments From the Financial Management
Service**

comment 3 and our discussion in the “Agency Comments and Our Evaluation” section.

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